

Holdout Creditor Litigation

An assessment of legislative initiatives to counter aggressive sovereign debt creditor litigators

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A special thank you to Helena for all the coffee breaks

List of Acronyms and Abbreviations

BITs	-	Bilateral Investment Treaties
CACs	-	Collective Action Clauses
DRC	-	Democratic Republic of Congo
ESM	-	European Stability Mechanism
EU	-	European Union
FSIA	-	Foreign Sovereign Immunities Act (USA)
HIPC	-	Heavily Indebted Poor Countries Initiative
ICSID	-	International Centre for Settlement of Investment Dispute
IMF	-	the International Monetary Fund
MDRI	-	Multilateral Debt Relief Initiative
NGO	-	Non-Governmental Organisation
ODA	-	Official Development Aid
SIA	-	State Immunity Act (UK)
UK	-	United Kingdom
USA	-	United States of America
WB	-	the World Bank

1 Introduction

1.1 Research question

This thesis concerns legislation enacted in Belgium, the UK and within the euro zone countries. At the heart of my research is the following question: do these legislative initiatives succeed in 1) discouraging minority creditors from refusing to take part in restructuring processes, including debt relief initiatives, and 2) limiting creditor lawsuits against defaulting sovereign debtors? The thesis will also look at recent legal developments that have arisen since the Argentine economic crisis in 2001, and examine whether these developments are likely to affect the above-mentioned legislation.

In order to answer the research question, the thesis will examine sovereign debt contracts (including sovereign bonds) in the international credit market and how these are enforced within different jurisdictions. It will further examine how different countries seek to limit the possibility of enforcing certain contract rights within their jurisdiction through national legislation. First, in section 1.2, the pressing issues are illustrated through a recent case.

1.2 A novel litigious strategy and counter reactions

1.2.1 Democratic Republic of Congo v. FG Hemisphere LLC

In 1980 and 1986, Zaire (now Democratic Republic of Congo (DRC)) entered into a contract with the Yugoslav company Energoinvest for the purpose of constructing a hydro-electric facility and high-tension electric transmission lines in the country.¹ Towards the end of the 1980s, both the government and its state-owned electricity company had defaulted on their debt. In 2003, two International Chamber of Commerce arbitrations, respectively in France and Switzerland, issued two awards requiring the DRC to repay the original loans plus 9 per cent interest and litigation costs. On 16 November 2004, Energoinvest sold its claims to the investment fund FG Hemisphere LLC at a steep discount compared to face value.² After successfully having requested that the District court of Columbia oblige the Democratic Republic of Congo to give detailed information on all valuable state-owned assets located anywhere in the world, FG Hemisphere commenced legal action against the DRC in the Bahamas, Australia, Hong Kong, Jersey, South Africa and the USA. At this point, the claims set forward amounted to US\$125.9 million and represented principal, interest and costs.³ In subsequent litigation in November 2010, the New South Wales Supreme Court in Australia ordered the Democratic Republic of Congo to ‘liquidate its shares and assets in Australian mining inter-

¹ Teresa Cheng & Adrian Lai (undated). The article refers to the cases FG Hemisphere v. DRC and Huatian-long (2009), (2010-1) and (2010-2).

² Bai (2013) 703.

³ *ibid* 703.

ests in order to repay FG Hemisphere' a total amount exceeding US\$31 million.⁴ It is assumed that FG Hemisphere bought the underlying debt for US\$3.3 million,⁵ making a 939 per cent return on the Australian suit alone.⁶

By the turn of the century, the DRC was in massive debt distress, not least due to a rough political period in the country's history. Whilst the DRC obtained independence from Belgium in 1960, General Mobutu Sese Seko seized power only five years later. His dictatorship lasted until 1997 when he was deposed in a coup d'état. The country was thereafter plunged into a civil war which resulted in the death of nearly 3.5 million people and came to an end in 2003.⁷ In July 2010, around the time when FG Hemisphere was suing the DRC to obtain full payment under the original loan contract from the 1980s, the large majority of the DRC's creditors provided debt relief to the country totalling US\$7251.5 million, through the enhanced Heavily Indebted Poor Countries (HIPC) Initiative.⁸ The HIPC initiative is a debt relief initiative, which was established by the International Monetary Fund (IMF) and the World Bank in 1996, with the aim of ensuring that no country faces a debt burden it cannot manage. The granting of debt relief is conditional on national governments meeting a range of economic management and performance targets.⁹ The HIPC debt relief granted to the DRC was composed of 36.3 per cent from multilateral creditors, 59.3 per cent from bilateral creditors and 4.3 percent from commercial creditors.¹⁰ Following debt relief, the DRC experienced a decline in gross public external debt to just over 20 per cent of GDP at the end of 2010 (from about 55 per cent of GDP in 2009).¹¹ Today the DRC is no longer in debt distress, but it is still a country facing great challenges, as evidenced by its low ranking in the Human Development Index (186th).¹²

1.2.2 Political reactions

The scenario described above - in which a creditor sues a defaulting sovereign debtor to obtain full payment - is a result of the basic legal structure of international sovereign lending and borrowing. In international sovereign borrowing and lending there are no legally binding bankruptcy mechanisms, and the restructuring of sovereign debt is voluntary. When a sovereign debtor defaults on its payment obligations creditors may choose to accept a renegotiation

⁴ ibid 704.

⁵ Madlena, O'Kane & Palast (2011).

⁶ Bai (2013) 705.

⁷ FN-sambandet (2015).

⁸ African Development Bank Group (2011) iii.

⁹ IMF (2015).

¹⁰ African Development Bank Group (2011) 7.

¹¹ ibid 2.

¹² United Nations Development Program (2013).

of the loan terms, such as prolonging the maturity of the loan, lowering the interest rate or granting debt relief. There is always a possibility that creditors will not participate in debt restructuring or renegotiate the terms of the loan agreement (this is referred to as ‘holding out’ from a debt restructuring). In such situations, the original terms of the loan agreement are still valid between the sovereign debtor and the holdout creditor. This voluntary approach to debt restructuring has allowed for the development of a business model. The strategy behind this business model consists in purchasing distressed debt on the secondary market, often at a steep discount, with the intent of suing or threatening to sue, in order to recover the full amount.¹³ Investment funds specialized in such strategies are sometimes called ‘distressed debt funds’ or ‘vulture funds’; the latter is a term which clearly signals ethical condemnation of the funds’ business practices.

The dispute between the Democratic Republic of Congo and FG Hemisphere over defaulted sovereign debt is not an isolated incident. Recent academic contributions suggest that we are witnessing an increase in creditor litigation and ‘runs to the courthouse’.¹⁴ Even though the amount of litigation is rather limited, research confirms that the number of default-related lawsuits in New York and London has been increasing since the 1980s. The precise scope of the described behaviour is still not well documented, but is ‘widely regarded as a main obstacle to sovereign debt restructurings and debt relief initiatives in low-income countries’.¹⁵

These kinds of creditor lawsuits, some of which are carried out by so-called vulture funds, have caused strong reactions from a broad spectrum of international and national actors. In a speech to the United Nations in 2002, the then Chancellor of the Exchequer (UK Minister of Finance) Gordon Brown, said:

‘We particularly condemn the perversity where Vulture Funds purchase debt at a reduced price and make a profit from suing the debtor country to recover the full amount owed - a morally outrageous outcome (...)

Whenever a country has to defend a legal case it has to divert considerable time, attention and resources away from focusing on poverty reduction, health and education and we must do everything we can to stop this shameful practice.’¹⁶

¹³ African Development Bank Group (undated).

¹⁴ Das, Papaioannou & Trebech (2012) 50.

¹⁵ *ibid* 50.

¹⁶ Debt Relief Bill (2010) 11.

At a G8 Finance Ministers meeting in 2007, the ministers expressed concern ‘about the actions of some litigating creditors’ against Heavily Indebted Poor Countries, and ‘agreed to work together to identify measures to tackle this problem, based on the work of the Paris Club’ (an informal group of creditor countries).¹⁷ That same year the Paris Club made a commitment not to sell debt on the secondary market to creditors that refused to take part in debt relief initiatives. In 2008, a similar agreement was signed by the member states of the European Union (EU). Furthermore, signatories to the United Nations’ Doha Declaration Financing for Development also stated that they were ‘deeply concerned about increasing vulture fund litigation’ and called on ‘creditors not to sell claims on HIPC countries to creditors that do not participate adequately in the debt relief efforts’.¹⁸

In some countries, the practice of holdout creditors has led to the enactment of legislation. Both Belgium and the United Kingdom (UK) have experienced creditor law suits against defaulting sovereigns within their own jurisdiction. In an attempt to curtail litigious creditor behaviour they chose to enact legislation in 2008 and 2010 respectively. In addition, in 2012, the euro zone countries enacted legislation aimed at preventing minority creditors from holding out from sovereign debt restructurings. The euro area legislation was not based directly on experiences with so-called vulture funds. However, several euro countries were (and still are) in a situation of debt distress and are likely to face challenging debt restructurings with possible holdout creditors.¹⁹ It is arguable that the choice of the euro countries to enact legislation is based on fear concerning the management of future debt crisis in the euro zone.

My thesis will further examine these three separate legislative responses and determine whether they have succeeded in reaching their goals. Before turning to the examination itself, I will clarify some of the terminology central to the thesis and provide a more detailed description of the problem of holdout creditors in sovereign debt restructurings.

1.3 Terminology

1.3.1 Sovereign debt

The term ‘sovereign debt’ will be used to describe all credit which a sovereign state has borrowed and is under an obligation to repay to its creditors, irrespective of whether it is held in national or foreign currency. It refers both to debt issued and guaranteed by the government of

¹⁷ *ibid* 13. The Bill cites a Pre-Summit meeting by G8 Finance Ministers in Germany 19. May 2007.

¹⁸ *ibid* 13.

¹⁹ The background for the enactment of the law in the euro zone countries may also be linked to the desire to avoid having to bail out other euro zone countries in debt crises. The legislation paves the way for a market-oriented solution to sovereign debt crises making it easier for the sovereign debtor to restructure its debts with its creditors.

a sovereign state.²⁰ It does not include outstanding payment obligations. Sovereign bonds constitute one category of sovereign debt.

1.3.2 Restructuring

There is no universally accepted definition of sovereign debt restructuring. In this thesis the term restructuring refers to *voluntary* negotiations between the sovereign borrower and its creditors resulting in an ‘exchange of outstanding sovereign debt instruments, such as loans or bonds, for new debt instruments or cash through a legal process’.²¹ Compared to the outstanding debt instruments, the conditions in the new debt instrument usually implies extending the maturities of the debt, possibly lowering the interest rate and reducing of the principal amount to improve the sovereign lender’s capacity to repay over time. The debt reduction can be both indirect, through a rescheduling which defers contractual payments, or direct through debt relief with a reduction in the face (nominal) value of the old instruments.²² In this thesis, I focus on distressed debt restructurings, which can be defined as restructurings on terms less favourable to the creditor than the original bond or loan terms.²³ When I refer to debt restructurings throughout the thesis, I will normally include debt relief agreements in this category.

1.3.3 Default

Default events and debt restructurings are closely related but not identical. A *default* is a situation where the sovereign does not honour the original terms of the debt contract, either because it is unwilling or unable to do so.²⁴ This normally consists in the failure of a government to make a principal or interest payment in due time (beyond a possible grace period).²⁵

1.3.4 Holdout Creditors

A holdout creditor is a creditor who chooses not to participate in a sovereign debt restructuring. There are various types of holdout creditors and, as will be described in section 1.4.2, there are several legitimate reasons for creditors to hold out from restructuring processes. In my thesis I focus on minority creditors who refuse to take part in a sovereign debt restructuring accepted by the majority of the creditors, and who claim payment in accordance with the original terms of the loan contract. More aggressive types of minority holdout creditors are known by some as ‘vulture funds’. The main strategy of a vulture fund is to ‘buy sovereign debt instruments when a country is most vulnerable (defaulted or soon-to default sovereign

²⁰ Das, Papaioannou & Trebech (2012) 7.

²¹ *ibid* 7.

²² *ibid* 7.

²³ This definition is in line with the one provided by Standard & Poor, *see ibid* 7.

²⁴ Borensaztein & Panizza (2008) 3.

²⁵ *ibid* 8.

debt), which enables the funds to purchase the debt at a deep discount from its face value and attempt to enforce the full claims',²⁶ often through litigation in court.

1.4 Context and delimitations

1.4.1 Advantages of sovereign borrowing and reasons to restructure sovereign debt

If used well, sovereign borrowing is an instrument that can contribute to economic and social development and help achieve economic stability in a country.²⁷ Almost all states borrow, either to promote development, to invest in infrastructure, to fund warfare or just to ensure payment balance at all times. Unfortunately, some states default on their payment obligations. There are many reasons why countries default and end up in debt crisis: poor economic management, external economic shocks, civil wars, natural disasters and more. Even so, creditors do not avoid all investments that entail risks and do not fully hedge against a breach of contract (a default). To invest is to take risks, and risks are normally priced into the interest rate and premium of the investment.

The causes behind sovereign default are not the subject of this thesis. Instead, the thesis will focus on existing situations of debt crisis in which the sovereign debtor tries to resolve the crisis. A common tool used to resolve a debt crisis is to restructure the sovereign debt. As previously explained, a restructuring is a voluntary agreement between the sovereign debtor and the creditors, which normally involves extending the maturity of the loan, lowering the interest rate and sometimes reducing the nominal amount (debt relief). Debt restructuring will always be positive for the debtor country's economy because it means credit on better terms. On the other hand, when a sovereign debtor defaults or initiates a restructuring, it implies a loss for the creditors. However, in times of crisis where the sovereign is in economic distress, it can be beneficial for the creditors to accept a restructuring of the debt, as this may give the sovereign time to 'change policies and turn around its economy, allowing eventually greater payments to the group of all creditors than if the sovereign simply defaulted'.²⁸

There is also an ethical dimension to the question of why a state should be able to restructure its debts and why creditors should accept a restructuring offer. A sovereign debtor is after all a state with certain fiduciary responsibilities towards its citizens. In times of crisis, regardless of the causes, many will argue that there should be limits to how long a creditor can demand payment in accordance with the contract when the basic needs of citizens are not being met.

²⁶ Blackman & Muki (2010) 49, note 6.

²⁷ Li & Panizza (2011) 15.

²⁸ Choi, Declaration (2012) 7 -8.

1.4.2 Challenges

For a restructuring to be optimal – minimising the overall losses for the parties involved – it must be strictly necessary, and the restructuring offer made to the creditors must be neither overestimated nor underestimated. To ensure that all parties are willing to agree to a restructuring agreement, it is important that no one feels that the other parties involved are free riding on their own losses: the debtor state must show willingness to make structural economic changes (cuts in their national budgets, raise more taxes etc.) and all creditors must accept losses in the restructuring process, whether in the form of lower interest rates, prolonged maturity or sometimes even debt forgiveness.

Although an offer to restructure may be beneficial to the group of creditors, an individual creditor may nonetheless profit by ‘demanding a disproportionately greater payment than the amount received by the rest of the creditors in a restructuring’.²⁹ For this reason, some creditors refuse to participate in restructurings (holdout creditors) and threaten to sue or actually sue, in order to receive payment in accordance with the terms of the original loan agreement. Such holdout strategies, and especially the more aggressive strategy including litigation, have several negative consequences on the sovereign debt market:

- *Reduced poverty reduction and slower economic recovery:* Holdout creditors and sovereign debt lawsuits threaten the objectives of debt relief initiatives (such as the HIPC-initiative) by reducing the impact of debt relief for the countries concerned.³⁰ Holdout creditors also reduce the economic effects of a restructuring, which may result in a slower economic recovery for the debtor country.
- *Taxpayer backlash:* When the impact of sovereign debt restructurings or debt relief is reduced due to certain actors free riding, there is a danger of so-called ‘taxpayers backlash’.³¹ When taxpayers realize that their taxes meant for debt relief, are in fact being used to pay claims from holdout creditors, they may become reluctant to support

²⁹ *ibid* 8.

³⁰ The total cost of providing debt relief to the 39 countries that have been found eligible or potentially eligible for debt relief under the enhanced HIPC Initiative was estimated to be about US\$74 billion (in end-2012 net present value terms). Approximately 44 per cent of the funding comes from the IMF and other multilateral institutions and the remaining amount comes from bilateral creditors. The IMF states that smaller multilateral institutions, non-Paris Club official bilateral creditors, and commercial creditors, account for about 26 per cent of total HIPC Initiative costs. These creditors have only delivered a small share of their expected relief so far. Non-Paris Club bilateral creditors as have delivered around 47 per cent of their share of HIPC Initiative debt relief. One third of these creditors have not delivered any relief at all. See more at: IMF (2015).

³¹ African Development Bank Group (undated).

their government's participation in future sovereign debt restructurings, debt relief initiatives, development aid programs etc.

- *Hold-out and litigation costs:* Creditors hold out from debt restructurings in order to force the debtor to repay in full.³² This holdout behaviour makes the restructuring process more difficult, dragging it out and creating uncertainty for all parties involved.³³ The result is often increased costs for both the sovereign debtor in economic distress and the remaining creditors. The litigation process is also costly for a sovereign debtor, draining money and work force away from other important policy and development issues. When a holdout creditor obtains a court ruling in its favour (stating that the sovereign creditor must pay the holdout creditor in full), it exerts pressure on the sovereign debtor by attempting to seize the sovereign debtor's assets abroad. Such proceedings are always burdensome to the debtors concerned: it may cost millions in legal expenses and can complicate financial and reserve management, because the debtor country must avoid placing valuables where they can be seized. Furthermore, if the practice of minority creditors holding out from restructurings becomes widespread, it may result in non-holdout creditors taking this possibility into account in their risk calculations, so increasing lending costs.
- *Inequitable burden sharing amongst creditors:* When creditors hold out from sovereign debt restructurings, the debtor country may have to pay more to the holdout creditor than to the creditors participating in the restructuring, either through holdout litigation or due to the threat of such action. While creditors agreeing to the restructuring agreement take their share of the losses connected to a debt crisis, holdout creditors become free riders.
- *Restructuring incentives:* If holdout creditors succeed in their holdout strategy, it is likely that other creditors will become reluctant to accept future restructurings. When other creditors realise that a holdout creditor seeking to make more individually, they will be tempted to adopt the same strategy. The higher the price demanded in a restructuring process and the greater the number of creditors that choose to hold out, the more difficult it is to successfully conclude a sovereign debt restructuring.³⁴ The IMF has stated that 'debt restructurings have often been too little and too late, thus failing

³² As previously mentioned, the restructuring only binds the participating creditors and does not change the legal obligations laid down in the contract between the sovereign debtor and holdout creditors.

³³ African Development Bank Group (2011).

³⁴ Choi, Declaration (2012) 8.

to re-establish debt sustainability and market access in a durable way'.³⁵ The loss of incentives to restructure can further increase the costs of a debt crisis, making it harder for the debtor country's economy to recover.

It is important to note that there are legitimate reasons for refusing to participate in a restructuring process. It is easy to argue that it is reasonable to hold out if the sovereign debtor is giving unjustified differential treatment to creditors in the restructuring agreement, or is abusively asking creditors to accept excessive losses. Further, it is of course a relevant concern that it may become too easy for the sovereign borrower to obtain debt restructuring.³⁶ Such a situation constitutes a moral hazard and would be suboptimal because it increases creditors' losses and makes it more expensive for the sovereign to borrow in the future. There are also arguments in favour of the more aggressive litigious holdout strategy. This line of argument focuses on the integrity of contracts, the wellbeing of the financial market, and the fact that litigious creditors have a corrective effect on a market where in which it is all too easy for sovereigns to get access to credit and to default.³⁷ I fully acknowledge the importance of limiting the incentives for hazardous behaviour when it comes to over borrowing and the misuse of restructurings that causes damaging losses for their creditors. However, my thesis will concentrate on the challenge posed by minority creditors holding out from restructurings and so free riding on the losses of both the sovereign debtor and the majority of the creditors, which threatens the goal of voluntary sovereign debt restructurings. This is also in line with the aims of the UK, Belgium and euro zone legislative initiatives mentioned in the previous section, which I will examine further in chapter 3.

1.5 Structure of the thesis and methodology

As noted in section 1.1, this thesis will examine whether the legislation enacted in Belgium, the UK and within the euro zone countries succeeds in its aims of limiting 1) the ability of

³⁵ IMF (2013).

³⁶ Many academics have discussed this moral hazard. Here is just one example of the general line of argument: *'Much of the debate surrounding possible changes to (or reform of) the institutions governing sovereign debt restructuring has been aimed at reducing the costs (in terms of both time and other resources) associated with reaching agreement as to the terms of that restructuring. While this appears to be in the best interests of a sovereign country that is already in default, it is important to note that reductions in the costs of default will also affect the incentives of the country to borrow appropriately and avoid default in the future. In turn, this will affect the terms on which creditors will lend to the sovereign. That is, it is entirely possible that the country in default may be made worse off through the introduction of a relatively costless debt restructuring process if this process significantly limits their ability to borrow in the future.'* See Wright (2011) 6.

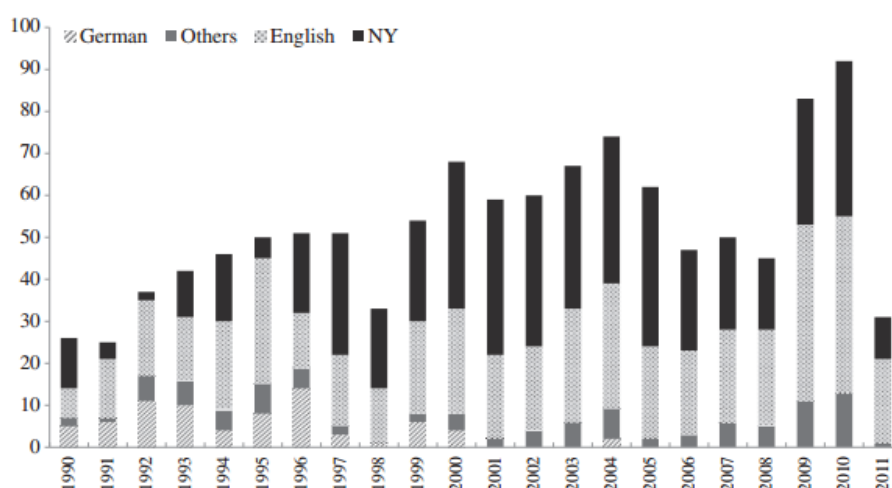
³⁷ The secondary market for debt obligations that enables the vulture funds' operation is often said to be a fundamental feature of sovereign borrowing and lending; when creditors can freely 'sell the debt they hold on the secondary market, there is less risk involved in lending to sovereigns, and creditors are therefore more likely to provide the capital sovereigns need'. See African Development Bank Group (undated).

creditors to hold out from restructuring processes, including debt relief initiatives, and 2) creditor lawsuits against defaulting sovereign debtors.

To understand the behaviour of holdout creditors, and national legislative responses, it is essential to understand the legal environment in which sovereign lending and borrowing operate. In Chapter 2, I will describe the legal framework for sovereign lending and defaults, including some basic explanations of the process of litigating a claim against a defaulting sovereign debtor. In describing this legal environment, I will to a certain extent try to detach it from a specific jurisdiction and instead focus on the current international trends. This more general examination of legal tendencies and legal developments within the sphere of sovereign lending and borrowing will be based on case law and national legislation from Western countries deemed important in commercial and financial matters. In addition, I will refer to legal scholars who have analysed these legal developments.

Throughout the thesis there will be an overrepresentation of examples from New York and English legislation and case law. My justification for this is that the laws of England and New York are those in which international sovereign bonds are most commonly issued (see figure 1 below). They are estimated to represent approximately 48 per cent and 40 per cent respectively of the notional amount of outstanding stock of international sovereign bonds.³⁸

Figure 1: Total number of bond issues by governing law ³⁹



Chapter 2 will also look into the doctrine of sovereign immunity, which is an important public law feature found in the legal framework of sovereign lending. The topic is well covered by

³⁸ IMF (2014) 6.

³⁹ Bradley & Gulati (2013) 12.

case law, national legislation and by legal scholars.⁴⁰ When presenting the content of the doctrine of sovereign immunity in the context of sovereign debt litigation, I will build on the United Nations Convention on Jurisdictional Immunities of States and Their Property ('the UN Convention on Immunities'). Though not yet in effect, the convention is largely considered to express current customary international law.⁴¹ I will however complement the presentation of the doctrine of sovereign immunity with examples of legislation and case law from the USA and UK (especially England).

Chapter 3 will present three legislative initiatives, each of which intends to improve the incentives for creditors to take part in restructuring processes and prevent litigious creditors from obtaining full repayment under the original non-restructured loan agreement. I will examine legislation from Belgium, the United Kingdom and the euro zone countries. The legislative acts have different preparatory histories and rationales, which will be explained before the content of the legislation itself is presented. When presenting the legislation I will rely on the original legal provisions analysed in the context of the preparatory documents and legislative history. I will further discuss to what extent the three legislative initiatives have succeeded in providing incentives for creditors to participate in restructurings and in limiting the negative consequences of creditors holding out from debt restructurings. I will close the chapter by comparing the different legislative initiatives and discussing whether there remains a lack of incentives to take part in restructurings, such that holdouts and subsequent creditor litigation may still be commonplace. Unfortunately, existing legislation is relatively new and there is little case law to shed light on the different approaches. Furthermore, there is little research on the actual impact of the legislation, regarding for example the number of creditors holding out from restructuring or the number of creditors litigating for full payment. It is beyond the time frame of this thesis to collect such data and provide empirical evidence of the effects of legislation. For these reasons, I have chosen to keep the analysis of the legislation more general and theoretical. At the very end of chapter 3, I will however consider some empirical data on sovereign debt restructurings between 1950 and 2010. This will allow me to test the conclusions of the general analysis, and will shed light on the question of or not there is a real need – in practice - for stronger regulations to ensure successful sovereign debt restructurings.

Chapter 4 will look into recent legal developments within the sphere of sovereign lending that are likely to affect sovereign debt restructurings and disputes in the future. The starting point will be the Argentine default in 2001, because the legal developments - which I will examine - are connected to the outcome of legal proceedings which emerged in the aftermath of the

⁴⁰ See for example Fox (2008).

⁴¹ See for example the discussion in St.prp.nr. 33 (2205-2006) 2.

country's restructurings in 2005 and 2010. The legal developments which will be examined are 1) a novel interpretation of the so-called *pari passu* clause often found in sovereign bonds; 2) an injunction issued to ensure compliance with the *pari passu* order; and 3) the possibility that the International Centre for Settlement of Investment Disputes (ICSID) will accept jurisdiction over disputes related to sovereign debt contracts (sovereign bonds). I will thereafter discuss how the legislation in Belgium, the UK and in the euro area, will react to these recent legal developments, and whether further incentives are needed to ensure sufficient participation in future sovereign debt restructurings.

The subject of the thesis draws upon several legal disciplines and lies at the crossroads between international contract law, international private law, international public law, national public law and politics. Since the spectrum of relevant sources of law is broad, one of the main challenges is to explore the intersections between these legal disciplines.

2 The legal framework of sovereign lending, defaults and restructurings

The aim of this chapter is to establish the content of the law applicable to sovereign lending and borrowing. This is necessary both in order to 1) understand the motivations behind hold-out behaviour and the litigious strategies of some sovereign creditors, and 2) examine whether the legislative acts of Belgium, the UK and the euro zone countries succeed in their aim of limiting the negative consequences of holdout behaviour. In the following I will present the main legal features of sovereign lending, defaults, restructurings and sovereign debt litigation.

2.1 The Private Law Contract

Sovereign states, much like private persons and private corporations, acquire credit through contracts, which confer rights and impose obligations on the respective parties. A sovereign state can obtain finance through lending from private banks, states, international finance institution but also through the issuance of sovereign bonds.

Sovereign states are subjects of public international law, a branch of law that regulates the relationship between states. States are sovereign, and are therefore free to regulate their internal affairs through legislation and the exercise of judicial functions.⁴² However, a state does not act as a sovereign when it engages in commercial activity. The contracting of sovereign debt is made by virtue of the country's private autonomy. In other words, loans contracted by states or state-related entities, including financial operations involving the issuance of bonds, constitute transactions of a private nature and are in principle subject to the rules governing commercial loans. This was also established in *France v. Kingdom of the Serbs, Croats and Slovenes* (1929): 'Any contract which is not a contract between States in their capacity as subjects of international law is based on the municipal law of some country'.⁴³

2.2 Private International Contract Law and Party Autonomy

In establishing that the loan agreements of sovereign states are subject to private law, questions arise as to which court/ tribunal has jurisdiction to handle a sovereign debt dispute; what laws should apply to the debt contract; and which procedural laws should be followed. The answer is found in private international law, which is the area of law that regulates the choice of the governing law. Within private international law, conflict rules or choice-of-law rules seek to identify the laws governing international relationships.⁴⁴

⁴² Cordero-Moss (2014) 5.

⁴³ *France v. Kingdom of the Serbs, Croats and Slovenes* (1929) paragraph 86.

⁴⁴ Cordero-Moss (2014) 134.

When using the term ‘international’ in the context of private international law, I do not refer to international sources of law. Rather, the law is defined as ‘international’ because the *object* that the law regulates is international.⁴⁵ National law and international conventions have different definitions of the term ‘international’; one could therefore say that the definition ‘varies according to the criteria used by the interpreter’.⁴⁶ For example, the Convention on Contracts for the International Sale of Goods of 1980⁴⁷ is designed precisely for international circumstances, and Article 1(1) specifies that: ‘This Convention applies to contracts of sale of goods between parties whose places of business are in different States’. On the other hand, the Hague Convention on the Law applicable to the International Sale of Goods of 1955⁴⁸ sheds a different light on the definition of ‘international’ (without actually stating it). According to Article 1 of the Convention, the mere declaration by the parties is not sufficient to give a sale an international character. Thus, the Article indicates that a sale may be international ‘if there are some foreign elements to the transaction, but that this is not necessarily the place of business of the parties’.⁴⁹ The European Union Rome I Regulation on the Law Applicable to Contractual Obligations⁵⁰ regulates the choice of law for the EU. Article 1 (1) of the Regulation describes any situation involving a conflict between laws of different states as falling under its scope. This way the Article indirectly ‘opens the door even for the eventuality that the only foreign element to a transaction is the choice made by the parties of a foreign law...’⁵¹

Sovereign debt contracts usually carry with them several international features. For example, the parties to a loan contract or a sovereign bond are often domiciled in two different jurisdictions, meaning that the investor does not have his habitual residence in the debtor country. Further, many sovereign debt contracts (including sovereign bonds) are not subject to the law of the sovereign’s jurisdiction, but typically to a law of an outside jurisdiction, to immunise the contract from later national legislation that can lead to changes in the contract. In sovereign debt disputes, the question of whether the contract is of international character or not, and whether international private law is relevant, is not normally disputed.

More often disputes concerning sovereign debt turn on 1) the question of which law shall govern the sovereign debt contract and 2) which court actually has jurisdiction over a sovereign debt dispute. The law governing the contract must be identified by the conflict rules of

⁴⁵ Cordero-Moss (2013) 19.

⁴⁶ See Cordero-Moss (2014) 3.

⁴⁷ CISG (1980).

⁴⁸ The Hauge Convention (1955).

⁴⁹ Cordero-Moss (2014) 3.

⁵⁰ Rome I Regulation (2008).

⁵¹ *ibid* 4.

the ‘state where the court where the action is brought has its venue’ (*lex fori*).⁵² Each state has its own conflict of law rules. Some of the national choice-of-law rules are of international origin, and their sources are found in supranational regulation and are applicable in a state via for example international conventions ratified by that state.⁵³ Some national choice-of-law rules are contained in national legislation, such as the Norwegian Act on the Law Applicable to Insurance Agreements of 1992, an act regulating choice of law in a specific sector.⁵⁴ Other choice-of-law rules are customary or based on judicial precedents, as is the case of most Norwegian private international law.⁵⁵ In contractual matters, private international law is generally dominated by the principle of party autonomy, recognized as a conflict of law-rule in the vast majority of states participating in international trade and business.⁵⁶ It follows that the parties to a contract are free to choose the law governing their relationship, or in other words, to choose what law(s) the court or tribunal shall apply to each aspect of the dispute. The parties to the contract can also choose the forum where the parties want future disputes to be dealt with. This can be regulated in a forum selection clause which refers to a particular court in a jurisdiction agreed upon and/or to a specific kind of dispute resolution, such as mediation or arbitration. Modern lending agreements and sovereign bond contracts usually contain both governing law clauses and forum selection clauses to ensure that only one specific court is given the task of interpreting the contract terms, applying one (or several) specific set(s) of rules.

Despite the fact that it is possible to choose the governing law and the forum, conflicts over these questions still arise. This can be partly explained by the fact that conflict of law-rules differ between countries and may therefore determine that different laws govern the same relationship.⁵⁷ Furthermore, the conditions for exercising party autonomy may vary according to the private international law rules in each state.⁵⁸ These issues of restriction on - and conditions for - the exercise of party autonomy (such as *ordre public*), are thoroughly discussed elsewhere and will not be addressed in this thesis.⁵⁹ I will mainly concentrate on circumstanc-

⁵² *ibid* 134.

⁵³ One example may be the European Regulation on the Law Applicable to Contractual Obligations, *See Rome I Regulation* (2008), as mentioned in the previous section.

⁵⁴ Forsikringsavtaleloven (1989).

⁵⁵ Cordero-Moss (2014) 134.

⁵⁶ Franzina (2013) 11. *See also* Cordero-Moss (2014) 135.

⁵⁷ Cordero-Moss (2014) 135.

⁵⁸ *ibid* 136.

⁵⁹ Amongst other, see *ibid*. *See also* Wood (2007).

es where the parties' choice of law does not conflict with national regulations, and where the contracting parties' choice of law is upheld.⁶⁰

2.3 Disputes arising from the Sovereign Debt Contract

2.3.1 Sovereign 'Bankruptcy Law'

When discussing the legal framework of sovereign debt, it is important to remember that, contrary to private defaults, there is no national or international bankruptcy procedure that can ensure an orderly restructuring of the debt of a 'bankrupt' sovereign.⁶¹ Many suggestions for an orderly bankruptcy or restructuring procedure have been made, at least since the time of Adam Smith.⁶² As yet, no international system for a comprehensive sovereign debt restructuring procedure has been adopted.⁶³ When a sovereign state is unable to meet its obligations, it is currently the sovereign debtor's responsibility to enter into voluntary negotiations with its creditors - a mixture of public and private entities with disparate agendas - and to seek acceptable restructuring of its debts.⁶⁴ But a creditor may choose to hold out, rather than accept a voluntary restructuring. When a creditor holds out from a restructuring process, it is a means of exerting pressure on the debtor to make sure it fulfils its commitments according to the contract, or at least improves the restructuring offer. If the sovereign debtor does not fulfil its obligations according to the contract but defaults on its non-restructured obligations, the hold-out creditor may choose to bring litigation to uphold its rights under the contract.

2.3.2 Judgment on the Merits and Enforcement

If a holdout creditor wants to uphold his rights under the original contract, it is first necessary to obtain a judgment on the merits, confirming the creditor's claim. The holdout creditor will

⁶⁰ One exception to this is the discussion in chapter 4.3, on the jurisdiction of the International Centre for Settlement of Investment Disputes (ICSID) in sovereign debt litigation.

⁶¹ In reality there is no such thing as a bankrupt state, but the term usually refers to a sovereign state in economic distress who defaults on payment obligations.

⁶² Blackman & Mukhi (2010) note 6 citing Adam Smith's *The Wealth of nations*: 'When it becomes necessary for a state to declare itself bankrupt, in the same manner as when it becomes necessary for an individual to do so, a fair, open, and avowed bankruptcy is always the measure which is both the least dishonorable to the debtor, and least hurtful to the creditor'.

⁶³ Amongst more recent suggestions are the global sovereign debt restructuring mechanism (SDRM) suggested by IMF management. See, e.g., Krueger (2002) and IMF (2002). Furthermore, the establishment of a Debt Workout Mechanism has been suggested by the United Nations Conference on Trade and Development (UNCTAD) See UNCTAD (undated). The IMF suggestion was rejected in the early 2000s, and up until now there has been little political will to work towards a comprehensive international debt restructuring procedure. On 8 September 2014, the United Nations (UN) General Assembly adopted a resolution mandating the UN to work on a multilateral legal framework for debt restructuring. This may be an indication of changing mentality towards a so-called statutory approach, but as of now, the USA and the vast majority of European countries are boycotting the process. See Nicols (2014).

⁶⁴ Different informal institutions such as the Paris Club (for official sovereign lenders) and the London Club (for private lenders) have gathered to safeguard their interests in cases of restructuring.

normally seize the court agreed upon in the contract, in accordance with the principle of party autonomy in private international law, as explained in the previous section. If the plaintiff (the holder of the payment claim) obtains a judgment on the merits stating e.g. that the sovereign debtor must repay the loan, interest and legal costs, the next question is how to execute this judgment and attach the property of the judgment debtor.⁶⁵ All developed jurisdictions provide methods for the enforcement of a judgment through execution of the debtor's property.⁶⁶ An order from a court to seize specific property is often called an attachment, and is used both as a pre-trial provisional remedy and to enforce a final judgment. Courts may attach debtors' property to help pay their creditors, 'either by directly transferring the property to the creditors, or by selling it and giving the creditors the proceeds'.⁶⁷ As will be explained in section 2.4, the procedure of attachment is often more complex in cases involving attachment of sovereign states' property.

Within the context of sovereign creditor litigation, one of the challenges for a creditor holding a payment order is to find attachable objects: the sovereign judgment debtor may not have sufficient assets within the jurisdiction where proceedings have taken place, and other attachable property may be placed all around the world. In this situation, it is important to know whether the obtained court order/judgment is directly enforceable in other jurisdictions, such that the holder of the judgment may follow the borrower's assets into those jurisdictions. The judicial effects of a legal proceeding only have direct effect within the confines of the national jurisdiction, and it is universally true that a lender cannot enforce a judgment directly in a third country.⁶⁸ However, bilateral agreements and international treaties such as the Lugano Convention,⁶⁹ the Brussels I Regulation⁷⁰ and the New York Convention⁷¹ have facilitated freer movement particularly of money judgements, between jurisdictions. Such agreements and conventions ensure that a national court will enforce a judgment or an arbitral award made within the jurisdiction of one of the contracting parties.⁷² There are however several

⁶⁵ Wood (2007) 155.

⁶⁶ *ibid* 172.

⁶⁷ Wex (2015)

⁶⁸ Wood (2007) 155. This is a general description and national legislation may vary.

⁶⁹ Lugano Convention (1968) and the Revised Lugano Convention (2007).

⁷⁰ Brussels I Regulation (2000).

⁷¹ New York Convention (1958).

⁷² It can be useful to be aware of the difference between recognition and enforcement of foreign judgements. While enforcement involves positive relief, such as an order for attachment of assets or an injunction, recognition does not require any affirmative action. In the latter case the judgment is merely regarded as affecting interests, eg through preventing further litigation due to *res judicata*. The general rule is that, if the foreign judgment qualifies for enforcement, then it also qualifies for recognition, eg the foreign court held the defendant liable or decided that the defendant was subject to an exclusive jurisdiction clause. *See more in* Wood (2007) 156.

different agreements and conventions, and countries may sign different agreements or none at all. For these reasons, the enforcement of foreign judgments may still vary between countries and be subject to different conditions and restrictions. These restrictions and conditions will not be investigated in this thesis. A further type of restriction on the possibility to litigate and enforce sovereign debt contracts will, however, be discussed in the following section. This is the restriction connected to the doctrine of state immunity, which limits the normal procedure of litigation described in this section.

2.4 Sovereign Immunity

2.4.1 General introduction

Sovereign debt litigators benefit from the free(r) movement of money judgments from one jurisdiction to another, facilitated by bilateral agreements and international agreements such as the Lugano Convention, the Brussels I Regulation and the New York Convention. However sovereign debt litigators are at the same time constrained by public international law. As Dr Michael Waibel states:

‘The topic of sovereign defaults lies at the intersection of private and public international law. When creditors enforce sovereign debt obligations, the cases represent an exclusively private character, at least at first sight. [...] The presence of the sovereign debtor transforms such a dispute into one of a very particular kind. Disputes arising out of sovereign default are of a hybrid character and implicate important question of public international law. Most sovereign defaults cannot be settled satisfactorily purely on the basis of contract law.’⁷³

One of the public international law features that Waibel refers to here is the sovereign-immunity rules. There are two categories of sovereign-immunity protection for foreign states: 1) immunity from jurisdiction and 2) immunity from execution. Immunity from jurisdiction refers to a ‘limitation of the adjudicatory power of national courts, whereas immunity from execution restricts the enforcement powers of national courts or other organs’.⁷⁴ This concept of state immunity covers both the state as such and its property. The immunity which one sovereign grants another in its own courts has traditionally been justified under the principle of state sovereignty. According to the principle of sovereignty in international law, no state is to be subject to the will of another state. This is connected to the principle of equality, and suggests that all states enjoy the same rank. Sovereign immunity can be seen as a manifestation of these two principles, and they may explain why it is deemed inappropriate for a sovereign

⁷³ Waibel (2011) 21.

⁷⁴ Reinisch (2006) 803.

state to be sued in the national courts of another sovereign state.⁷⁵ A more functional explanation of sovereign immunity is that states are equal subjects of governance with exclusive power within a defined territory, and that the courts of one state should not be able to test the validity or legitimacy of another State's exercise of authority within its own territory.⁷⁶ Some legal scholars have also noted that state immunity in practice was probably based on 'the expedient of gaining reciprocity and because judicial actions caused diplomatic antagonism'.⁷⁷ While these justifications mainly concern immunity from jurisdiction, immunity from execution provisions are said to stem more directly from concerns about the disruption and political ramifications that can result from the seizure of a foreign state's property.⁷⁸

Sovereign states have long been privileged subjects of international law: prior to the twentieth century there were few countries in the world that permitted their courts to process claims brought by private citizens against foreign sovereigns.⁷⁹ However, as states became increasingly involved in ordinary commercial activities, the maintenance of sovereign immunity was perceived to be unjust treatment of private contractors. Today, most commercially significant jurisdictions subscribe to the 'restrictive' theory of sovereign immunity. The argument for a more restrictive approach is that when a 'sovereign descends to the market place, he must accept the sanctions of the market place'.⁸⁰ In the following section I will consider the sources of law related to the doctrine of restrictive state immunity. Thereafter I will examine the content of the doctrine of sovereign immunity itself.

2.4.2 The sources of law

At the national level, the transition to the restrictive doctrine of sovereign immunity happened in the French Cour de Cassation in 1969, in the US Supreme Court in 1976 and in the English Court of Appeal in 1977.⁸¹ Later, the doctrine of restrictive state immunity was laid down in US and UK law, in the Foreign Sovereign Immunities Act (FSIA)⁸² and the State Immunity Act (SIA) 1978⁸³ respectively. At the international level, there was no authoritative source for the doctrine of restrictive immunity prior to 2004, so it had to be 'derived from international

⁷⁵ St.prp.nr. 33 (2005-2006) 1.

⁷⁶ Alvik (2006) 16.

⁷⁷ Wood (2007) 557.

⁷⁸ Blackman & Mukhi (2010) 48.

⁷⁹ Wood (2007) 557.

⁸⁰ *ibid* 557 and 560-570. The principle of restrictive immunity is codified in national law in some jurisdictions, such as the Foreign Sovereign Immunities Act (FSIA) in the United States.

⁸¹ Alvik (2006) 19. The changes happened in the cases: *Administration des Chemins de Fer du Gouvernement Iranien v. Société Levant Express Transport* (1969); *Alfred Dunhill of London Inc. v. Republic of Cuba* (1976); *Trendtex Trading Corporation Ltd. v. Central Bank of Nigeria* (1977).

⁸² Foreign Sovereign Immunities Act (FSIA) [USA].

⁸³ State Immunity Act (SIA) [UK].

custom as evidence in treaties, national legislation, court decisions and other State practice'.⁸⁴ In 1997, the International Law Commission, a specialised agency of the General Assembly of the United Nations, undertook a study of the law of state immunity based on all these sources. The International Law Commission finalized its Draft Articles on Jurisdictional Immunities of States and their Property in 1991 and concluded that there was a 'steady trend, with the exception of the People's Republic of China, towards all States accepting a restrictive doctrine and framed its draft Articles on that basis'.⁸⁵ In 2004, the UN General Assembly adopted the Convention on Jurisdictional Immunities of States and their Property ('the UN Convention on Jurisdictional Immunities'/'the Convention'), based on the 1991 International Law Commission Draft Articles. The Convention on Jurisdictional Immunities has not yet entered into force, but as of October 2014 it has been signed by 28 parties, including countries such as China, India, Japan, Iran, The Russian Federation, Switzerland and most of the members of the European Community including France and the UK. 16 countries have ratified the Convention, including Austria, Finland, France, Iran, Italy, Japan, Norway, Portugal, Saudi Arabia, Spain, Sweden and Switzerland.⁸⁶ Though not yet in effect, the Convention is largely considered to express current customary international law.⁸⁷ When presenting the content of the restrictive doctrine of sovereign immunity in the context of sovereign debt litigation, I will build on the UN Convention and complement it with legislation and case law mainly from the USA and England.

2.4.3 Immunity from Jurisdiction

The UN Convention on Jurisdictional Immunities regulates to what extent states and their property enjoy immunity from suit in the national courts of other sovereign states, and immunity from enforcement in connection with such lawsuits. Article 5 lays down the starting point by stating that a Sovereign state enjoys immunity, in respect of itself and its property, from the jurisdiction of the courts of another State. This is also the starting point of the US FSIA section 1604, and the UK SIA section 1(1).

Under the modern 'restrictive' theory of sovereign immunity, which the UN Convention intends to codify, a foreign state's immunity is subject to various exceptions, the extent of which is often at the heart of sovereign-litigation disputes.⁸⁸ One important exception to the immunity from jurisdiction is laid down in Article 7 of the UN Convention, and provides the state the opportunity to give express consent for jurisdiction to be exercised in proceedings

⁸⁴ Fox (2008) 3.

⁸⁵ *ibid* 3.

⁸⁶ UN Convention on Privileges and Immunities (1946).

⁸⁷ *See* for example the discussion in St.prp.nr.33 (2005-2006) 2. *See* also Alvik (2006) 19.

⁸⁸ Blackman & Mukhi (2010) 49.

before a court of another state. Express consent can be given through an international agreement, a written contract, or by declaration before the court in specific proceedings. A similar exception to sovereign immunity from jurisdiction based on state consent is also provided for in the US FSIA section 1605 and the UK SIA section 2(1) and 2(2).

Another important exception, which is relevant in the context of sovereign debt contracts, is set out in the UN Convention Article 10, and provides a general exception from immunity in relation to ‘commercial transactions’. By ‘commercial transactions’ the UN Convention refers to the distinction between the public acts of the government of a state (*jure imperii*) and its commercial acts (*jure gestionis*) (see Article 2(2)).⁸⁹ In other words, courts will arrest suit only where the activity is of a *governmental nature*. Precisely which activities are to be characterized as governmental in nature (as opposed to *jure gestionis*) is still under debate and varies between jurisdictions, but positions seem to be converging towards an agreement that the correct test is to consider what constitutes the ‘nature’ of the activity. Consequently, although an act may have a public purpose, ‘recourse to private means to achieve it will lead the courts to treat it as a commercial act and therefor the state will not be immunized’.⁹⁰ The US FSIA also accepts jurisdiction over foreign states when the action concerns different commercial activities carried out by the foreign state (1605(a)(2)). US FSIA section 1603(d) provides that ‘the commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transaction or act, rather than by reference to its purpose’. Several court cases in the United States have examined what is meant by the ‘nature of the act’, which may also shed light on the interpretation of the UN Convention. To determine the nature of a sovereign’s act, the court usually asks whether the particular actions that the foreign state performs (whatever the motive behind them) are the *type* of actions by which a private party engages in trade and traffic or commerce.⁹¹ The courts often start by examining the act of the foreign sovereign that serves as a basis for the plaintiffs claim. In *Republic of Argentina v. Weltover*, the Supreme Court concluded that when a sovereign purchases goods in the market, it has engaged in a commercial activity because such a purchase is ‘the type of action [...] by which a private party engages in trade and traffic or commerce’.⁹² The Supreme Court further held that ‘a state engages in commercial activity... where it exercises only those powers that can also be exercised by private citizens, as distinct from those powers

⁸⁹ Fox (2008) 502.

⁹⁰ Wood (2007) 561.

⁹¹ *NML Capital, Ltd., EM Ltd. V. Republic of Argentina* (30 Mar. 2013) 258, quoting *Republic of Argentina v. Weltover* (1992).

⁹² *ibid* 258, quoting *Republic of Argentina v. Weltover* (1992).

peculiar to sovereigns’.⁹³ Section 1(a) of the UK SIA provides that a state is not immune as respects proceedings relating to a commercial transaction entered into by a state. Section 3(3) further defines the content of ‘commercial transaction’ by listing core business activities in subsections 3(3)(a) and (b). The SIA does not manage to avoid the distinction between public and commercial completely, as section 3(3)(c) states that a commercial transaction also means ‘any other transaction or activity (whether of a commercial, industrial, financial, professional or other similar character) into which a State enters or in which it engages otherwise than in the exercise of sovereign authority’.⁹⁴

An exception to the exception from immunity from jurisdiction is found in Article 10(2) of the UN Convention, which provides that immunity can still be invoked in cases of commercial transaction between states if the parties to the commercial transaction have expressly agreed so. This is also accepted under the UK SIA section 3(2).

With respect to sovereign debt, it seems to be an international consensus that borrowing is a commercial act due to its commercial *nature* and therefore not immune as such, even if the proceeds are to be used for a government purpose. The evidence for such consensus is found both in legislation and in the many court cases regarding sovereign debt disputes around the world.⁹⁵ What is deemed more problematic – and this is often at heart of sovereign-debt disputes – is the question of which assets must be considered immune from *enforcement measures*.

2.4.4 Immunity from Enforcement Measures

Article 18 -21 of the UN Convention on Jurisdictional Immunities regulate state immunity from measures of constraint in connection with proceedings before a court of another state. Articles 18 and 19 speak only of a ‘proceeding before a court of another State’, which refers to the court of a state where the specific property is situated, regardless of the state in which the main proceedings are or have been taking place.⁹⁶

The introductory phrases of articles 18 and 19 embody the general principle of State immunity from measures of constraint and the following subparagraphs lay down the exceptions to

⁹³ *NML Capital, Ltd., EM Ltd. V. Republic of Argentina* (30 Mar. 2013) 259, quoting *Republic of Argentina v. Weltover*.

⁹⁴ Fox (2008) 542.

⁹⁵ Borrowings and loan guarantees, including bond issues, are expressly commercial under the State Immunity Act (1978) [UK] s 3 and the Foreign State Immunities Act (1985) [Australian] 11, and have been held to be so in France in *Societe Basue-Marchal et cie v Turkey* (1974) and in Italy in *Consorzio Agrario della Tripolitania v Federazione Italiana Conzorzi Agrari* (1984). See Wood (2007) 561.

⁹⁶ St.prp.nr. 33 (2005-2006) 13.

that principle. The convention distinguishes between pre-judgment (Article 18) and post-judgment measures (Article 19) of constraint, but the starting point is that the State enjoys immunity from enforcement measures in both cases. The concrete measures of constraint available vary from state to state, and the term ‘measures of constraint’ is meant to encompass a broad spectrum of measures (the list of alternatives is not exhaustive).⁹⁷ The most important measures in respect of litigation against sovereign debtor states, may well be the measures ensuring execution of the judgment (post-judgment), such as the attachment of certain property.⁹⁸

With respect to immunity from enforcement measures, the US FSIA is similar to the UN Convention: the starting point in section 1609 is that the property of a foreign state present in the United States is immune from execution, including of course execution in satisfaction of a debt.⁹⁹ Furthermore, such property may only be attached and executed upon when one of the exceptions in sections 1610 or 1611 applies. The UK SIA section 13(2)(b) also provides that a foreign State enjoys immunity from enforcement measures. A study by August Reinisch, Professor of International and European Law at the University of Vienna, has examined European court practice related to enforcement immunity, and concludes that it is far from uniform. Nevertheless, the study argues that certain common principles have emerged over the last decades, and that these principles are reflected in recent codification in the UN Convention.¹⁰⁰ In the following section, I will examine the *exceptions* to immunity from enforcement measures.

2.4.4.1 *Exception due to waiver of immunity*

As with immunity from jurisdiction, the UN Convention accepts that immunity from enforcement measures may be waived by the state. This is clearly reflected in Articles 18 and 19 of the UN Convention, which state that a State can expressly consent to waive its immunity from measures of constraint by international agreement, in a written contract or by a declaration before a court after a dispute between the parties has arisen. According to Articles 18(b) and 19(b) a state is also deemed to have waived its immunity in respect of specific assets if it has allocated or earmarked property for the satisfaction of the claim which is the object of the proceedings. It is important to point out that a waiver of immunity from jurisdiction does not

⁹⁷ *ibid* 13.

⁹⁸ Certain authors use expressions like execution, enforcement and attachment interchangeably, which can be confusing at least in a Norwegian setting. When talking of ‘enforcing’ or ‘executing’ a judgment I refer to the more general concept of legal processes to ensure that a judgment is being carried into effect, which in Norwegian can be translated as ‘tvangfullbyrde’. When using the word ‘attach’ I refer to the legal process of seizing property to ensure satisfaction of a judgment, which in Norwegian would be ‘å ta utlegg’.

⁹⁹ See for example *NML Capital, Ltd., EM Ltd. V. Republic of Argentina* (30 Mar. 2013).

¹⁰⁰ Reinisch (2006) 803 and 835.

encompass a waiver of immunity from enforcement. This is clearly stated in Article 20 of the UN Convention. In the USA, the FSIA section 1610(1) provides that property in the USA belonging to a foreign state and ‘used for a commercial activity in the US, shall not be immune from attachment... or from execution if ...the foreign state has waived its immunity from attachment in aid of execution or from execution either explicitly or by implication’. Subsections 1610(a)(1) and (d)(1) regulate cases of post-judgment and pre-judgment attachments. The UK SIA section 13(3) provides a similar exception to immunity from certain enforcement measures through the written consent of the State concerned.

2.4.4.2 Exception for Non-commercial Purposes / Commercial Activity

Article 19(c) of the UN Convention provides another exception to State immunity in respect of post-judgment measures of constraint. The article states that enforcement measures are available if:

‘It has been established that the property is specifically in use or intended for use by the State for other than government non-commercial purposes and is in the territory of the State of the forum, provided that post-judgment measures of constraint may only be taken against property that has a connection with the entity against which the proceeding was directed.’

The 1978 UK SIA provides for an almost identical exception in section 13(4), stating that there is an exception from immunity from enforcement measures against property which ‘is for the time being in use or intended for use for commercial purposes’.

A well-known European enforcement immunity case, *Phillipine Embassy Bank Account Case*, applies the same ‘purpose test’ in examining whether a State’s property is immune from an enforcement measure:

‘There is a general rule of international law that execution by the State having jurisdiction on the basis of a judicial writ of execution against a foreign State, issued in relation to non-sovereign action (*acta iure gestionis*) of that State’s things located or occupied within the national territory of the State having jurisdiction, is inadmissible without assent by the foreign State, insofar as those things serve sovereign purposes of the foreign State at the time of commencement of the enforcement measure.’¹⁰¹

¹⁰¹ *ibid* 808.

These are some examples of the consensus that exceptions to immunity from execution and enforcement measures against the property of a foreign State are accepted, when the property is in use or intended to be used for commercial purposes.

The exact determination of whether or not the requirement of a commercial purpose is fulfilled forms the core issue of the majority of enforcement immunity decisions. To clarify the content of the current exception, Article 21 of the UN Convention lists certain categories of state property that are not to be considered as property specifically in use or intended for use by the State for other than government non-commercial purposes under Article 19, subparagraph (c):

- a) property, including any bank account, which is used or intended for use in the performance of the diplomatic mission (...);¹⁰²
- b) property of a military character or used or intended for use in the performance of military functions;
- c) property of the central bank or other monetary authority of the State;
- d) property forming part of the cultural heritage of the State or part of its archives and not placed or intended to be placed on sale;
- e) property forming part of an exhibition of object of scientific, cultural or historical interest and not placed or intended to be placed on sale.

In the previously mentioned study by Reinisch, the author tries to identify types of property generally considered to serve sovereign or non-commercial purposes in European case-law. In his study, he finds that European case law generally follows the categories of property laid down in the UN Convention and other immunity instruments.¹⁰³ A list similar to the one in the UN Convention can for example be found in the UK SIA. Section 17 defines ‘commercial purpose’ as ‘purposes of such transactions or activities as are mentioned in section 3(3)’, that is, use in relation to a sale of goods or a supply of services, a transaction for provision of finance, or a commercial, industrial, professional, or industrial activity.

It is a common perception that the purpose-of-the-act-test has proved to include quite a broad spectrum of the economic activities of the State. The German Federal Constitutional Court stated that:

‘...the distinction between sovereign and non-sovereign cannot be drawn according to the purpose of the state transaction and whether it stands in a recognizable relation to the sovereign duties of the State. For, ultimately, activities of the State, if not wholly,

¹⁰² This also affects consular posts, special missions, missions to international organizations or delegations to organs of international organizations or to international conferences.

¹⁰³ Such as the Vienna Convention on Diplomatic Relations (1961).

then to the widest degree, serve purposes and duties and stand in a still recognizable relationship to them.’¹⁰⁴

If interpreted in accordance with the opinion of this German court, almost all acts of a State can be said to be acts for public purposes. The interpretations of the purpose-test may vary between jurisdictions, but it is generally agreed that the governmental purpose-test provides greater immunity for the State and its property, than the nature-test applied in relation to jurisdictional immunity.¹⁰⁵ The use of the word ‘purposes’ in the UN Convention and in other legislations may indicate a more cautious stand compared to the requirements for exception from immunity from jurisdiction, which refers to ‘the nature’ of the act.¹⁰⁶

The US FSIA also contains provisions granting exceptions to immunity from execution (post-judgment) for property used for commercial activity. Section 1610(a)(2) of the FSIA provides that ‘the property in the US of a foreign state ... used for a commercial activity in the US, shall not be immune from attachment... or from execution if 2) the property is or was used for the commercial activity upon which the claim is based’. The FSIA section 1603(d) further states that the ‘commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transaction or act, rather than by reference to its purpose’. The exception in the UN Convention refers to the *purpose* of the activity of the State, while the US legislation refers to the *nature* of the State activity. Thus it seems the USA have gone further in restricting the rules on sovereign immunity from execution. The US legislation and case law applies the same test of nature to both exemptions to immunity from jurisdiction and exceptions to immunity of execution. On the other hand, the UN Convention and several European countries rely on the less intrusive exemption from immunity from execution, applying the purpose-test.

2.4.4.3 Nexus requirement

In many jurisdictions there is an additional requirement in order to allow an exception to immunity from execution for property serving non-governmental purposes. To varying degrees, national legislation and international legislation and instruments demand some connection between the property against which enforcement measures are sought and the underlying claim.¹⁰⁷

¹⁰⁴ Fox (2008) 514, citing *Berizzi Bros v. Pesaro* (1925).

¹⁰⁵ See *ibid* 604 - 618.

¹⁰⁶ Reinisch (2006) 804.

¹⁰⁷ *ibid* 822.

The UN Convention does not require a direct link between the property and the underlying claim. It does however require that the property one seeks to attach have an additional connection over its commercial purpose: Article 19(c) requires the property to have a ‘connection with the entity against which the proceeding was directed’. Article 25 of the UN Convention states that the expression ‘entity’ in Article 19(c) means the State as an independent legal personality, a constituent unit of a federal State, a subdivision of a State, an agency or instrumentality of a State or other entity, which enjoys independent legal personality. In other words, the ‘nexus requirement’ in Article 19(c) must be read as bringing within its exception all property owned or possessed by the entity. Read in conjunction, Articles 19 and 25 provide an exception to immunity from attachment for *property* of a State agency engaged solely in commercial activities, in respect of judgments rendered against it.¹⁰⁸

Section 1610(a)(2) of the US FSIA permits execution measures if ‘the property is or was used for the commercial activity upon which the claim is based’ and thus clearly requires a connection between the property and the underlying claim.¹⁰⁹ The US FSIA nexus requirement can be said to serve two purposes. First, it ensures that execution of State property only takes place in respect of commercial activity which, pursuant to section 1605(a)(2) of the FSIA falls within an exemption to immunity and for which consequently the US courts have jurisdiction. Secondly, it ‘limits the property to satisfy the judgment to resources of the State already committed to the non-immune transaction’.¹¹⁰ This nexus requirement is only relevant where the execution is sought against the property of the State itself. In respect of execution sought against a State agency or instrumentality, attachment of all property used for commercial activity is permitted.¹¹¹ What distinguishes the US nexus requirement from the requirement in the UN Convention is that the latter provides for attachment of *all* the property of the State entity and not merely the property used for the commercial activity upon which the claim is based. At the same time, the UN Convention refers to the attachment of the property of the State entity which is a party to the proceedings and consequently against whom a judgment has been obtained. On this point, the UN Convention is more similar to the US FSIA under which execution is sought against a State agency or instrumentality.

The UK SIA is quite a liberal legislation and section 13(4) only requires that the property against which enforcement is being sought ‘is for the time being in use or intended for use for commercial purposes’.

¹⁰⁸ Fox (2008) 633.

¹⁰⁹ Reinisch (2006) 822.

¹¹⁰ Fox (2008) 633, footnote 70.

¹¹¹ *ibid* 633, footnote 71.

2.4.5 Preliminary Conclusions

As can be seen from the forgoing sections, the major jurisdictions have quite similar legislation when it comes to immunity from jurisdiction. Nevertheless, certain differences arise when it comes to immunity from enforcement measures. The differences include both the definition of what constitutes a commercial activity (purpose vs. nature-test) and whether or not there is an additional nexus requirement.¹¹² One thing all the different jurisdictions share is an increasingly liberal approach to sovereign immunity. Furthermore, and regardless of similarities and differences, all rules on sovereign immunity can in principle have a profound effect on insolvent states because there is no bankruptcy protection for sovereigns: there is no formal legal framework enabling the sovereign lender to freeze proceedings, and nor is there a framework offering the opportunity to discharge or write down the debt so as to start afresh with the majority creditor votes which bind dissenting creditors. ‘State immunity is therefore to some extent a corrective protection to the exposure of states to their creditors’.¹¹³ Today the question of sovereign immunity, both with respect to jurisdiction and execution, is often regulated in the sovereign debt contract, through an express waiver of sovereign immunity.¹¹⁴ Such waivers are usually recognized as ‘effective in the courts of the main countries under whose laws these agreements are documented, such as England and New York’¹¹⁵ and in the UN Convention on Sovereign Immunities, as demonstrated previously in this chapter. Despite the fact that such waivers are common, the execution of a sovereign debt judgment is still quite challenging in practice, due to the lack of attachable property. If the sovereign debtor truly wishes to evade payment obligations it can simply move its property around the world, from one place to another, all the while avoiding actual attachment. For sovereign debtors who worry about their economic reputation, this may be a risky behaviour. For the average sovereign debtor, even the threat of litigation from a holdout creditor is a cause for serious concern in terms of future access to credit and the inflow of foreign investments, and may therefore easily result in acceptance of the holdout creditor’s claim. Some legislators have found that the current legal system for sovereign lending and borrowing has been unsatisfactory, when it comes to handling sovereign debt restructurings. As previously mentioned, Belgium, the UK and the euro zone countries have all come up with legislative initiatives which aim to limit the possibility for creditors to hold out from sovereign debt restructurings and then litigate to obtain full payment under the original non-restructured loan agreement. These initiatives will be examined in the forthcoming chapter.

¹¹² *ibid* 634.

¹¹³ Wood (2007) 557.

¹¹⁴ Today most sovereign lending is bond lending, and when countries issue bonds in foreign markets, they almost always include waivers of immunity from suit and immunity from legal enforcement. Weidemaier (2014).

¹¹⁵ Wood (2007) 557.

3 Legislative Action

In this chapter I will give an account of three legislative initiatives in Belgium, the UK and in the euro zone countries. All initiatives have arisen as a result of a political desire to ensure that creditors participate in sovereign debt restructurings and to limit the negative effects of minority creditors holding out from restructuring processes. In presenting each legislative initiative, I will first consider the background to the legislation, before introducing the relevant provisions, and examining to what extent the legislation has been effective in reaching its goals.

3.1 Belgium – Immunity for Developing Aid, etc.

3.1.1 The backdrop

In 2007, an investment fund tried to execute a foreign award against the Democratic Republic of Congo (DRC) in Belgian Courts. The investment fund, Kensington International, bought DRC debt on the second hand market for US\$1.8 million. Between 2002 and 2003, Kensington International obtained four judgments against the DRC for ‘sums due under various loan and credit agreements’.¹¹⁶ As of 12 August 2005, the sums due, representing both principal and interest, amounted to US\$121.4 million. After having obtained the judgment, the investment fund tried to seize DRC funds worldwide, including 10.3 million euros of governmental funds in Belgium. These funds were part of a Belgian development aid package channelled through the Ministry of Finance and Development Cooperation and destined for the government of the DRC for the construction of a thermal power station.¹¹⁷

In April 2008, as a consequence of this case, the Belgian Senate unanimously approved both a resolution and a statute ‘to safeguard the Developments Cooperation and Debt Relief from the actions taken by Vulture Funds’.¹¹⁸ By doing so, it was the first country to take a direct legal stand against aggressive litigious creditors.¹¹⁹ The senators who discussed the legislation were also alarmed by the fact that Kensington International had registered more than 10 claims against the DRC. The DRC is a large recipient of Belgian official development aid and they feared that aggressive litigation by creditors would claim more Belgian Development money destined for the DRC.¹²⁰ The resolution itself justified the need for action by stating that:

¹¹⁶ Kensington International v. Republic of Congo (2005)

¹¹⁷ Jubilee USA (2008).

¹¹⁸ Jubilee USA (2008).

¹¹⁹ *ibid.* See also Wautelet (2011) 21. Belgium does however also have statutory law preventing attachments from being made on cash and securities settlement accounts with Belgian settlement bodies such as the National Bank of Belgium, Euroclear Bank S.A/N.V and Euroclear Belgium.

¹²⁰ Jubilee USA (2008).

‘In principle, what bothers the authors of this proposal is the fact that, when Western governments finally come to an agreement concerning debt relief, some unscrupulous private creditors circumvent international agreements relating to debt forgiveness.’¹²¹

The senators were thus concerned about the possibility that holdout creditors ‘circumvent multilateral efforts geared towards reduction or cancellation of debts of very poor countries’.¹²² This latter argument is related to the effectiveness of the implementation of large international debt relief initiatives, which will be further discussed in relation to the UK legislation in chapter 3.2.

3.1.2 The Legislation

Article 2 of the Act (6 April 2008) introduces a new provision in the Act of 25 May 1999, which organizes the legal framework for Belgian development aid cooperation.¹²³ The new provision reads as follows: ‘the funds and assets which are earmarked for international cooperation as well as the funds and assets earmarked for public development aid, other than those relating to international cooperation, cannot be attached or assigned’.¹²⁴ Article 3 of the Act makes an amendment to a Royal Decree reorganising the National Credit Agency and authorising the Minister of Finance and the Minister responsible for External trade relations, to make loans to states or foreign organizations. The amendment covers loans granted by Belgium to foreign countries and institutions and provides that such loans are un-attachable and unassignable.¹²⁵

3.1.3 Assessment

The Belgian statute regulates the enforcement of money judgments by limiting the availability of seizable property (making it immune). More precisely it excludes certain property from attachment, namely Belgian governmental funds allotted for international development purposes and loans granted by Belgium to foreign countries and foreign institutions. The main findings assessing the Belgian statute are that 1) the statute may contribute to preventing Belgium (as a creditor) from holding out from restructuring processes; 2) it may prove to affect

¹²¹ ibid 20, note 105 (author’s own translation).

¹²² Wautelet (2011) 20.

¹²³ Loi du 06/04/2008.

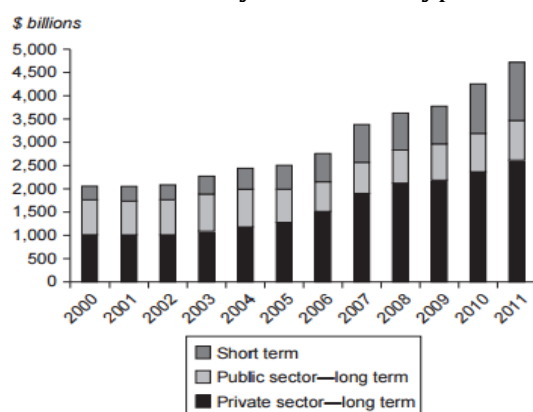
¹²⁴ The original Article 11 bis reads as follows : ‘*Les sommes et les biens destinés à la coopération internationale ainsi que les sommes et les biens destinés à l’aide publique belge au développement - autres que ceux relevant de la coopération internationale belge - sont insaisissables et incessibles*’.

¹²⁵ Article 3 of Loi du 06/04/2008 makes an amendment to law No. 42 of August 31, 1939 as amended by the Royal Decree No. 75 of 10 November 1967. The original wording is: ‘*Les montants des prêts consentis en application de l’alinéa 1er sont insaisissables et incessibles*’ – loosely translated by the author to: ‘*The amounts of loans made under paragraph 1 are elusive and not transferable*’.

only property situated within Belgian jurisdiction; and 3) it has limited effect on creditors' overall incentives to participate in restructurings. These findings will be substantiated in the paragraphs that follow.

Regarding the first finding, I claim that the Belgian statute may prevent the Belgian state from free riding on sovereign debt restructurings in the future. This argument is related to the question of tax payers' backlash, which was introduced in section 1.4.2. Both official development aid and losses born by state creditors participating in sovereign debt restructurings are ultimately paid for by the tax payers of a country. If governmental funds earmarked for developing countries end up in the pockets of a small group of creditors, the legitimacy of granting (taxpayers') money to developing countries is likely to be undermined. In other words, government policy, which consists of contributing to sovereign debt restructurings and debt relief initiatives for highly indebted poor countries, may lose support if the money does not reach those it is intended for. When Belgian politicians act against the misuse of official development aid and free riding on restructuring processes, this helps legitimize the Belgian government's use of (taxpayers') money in restructuring processes, including debt relief initiatives. There are good reasons to argue that it is essential that international finance institutions and governmental creditors, such as Belgium, contribute to debt restructurings in order to achieve optimal restructuring results. I have previously argued that the participation of *all* creditors is important to achieve optimal restructuring and to avoid free riding becoming a tempting option for even more creditors. While the private sector remains the biggest sovereign creditor, significant amounts of sovereign debt are owed to official creditors (both governments and international finance institutions, such as the IMF and the World Bank). The figure below shows the stock of external debt by borrower type (and maturity).¹²⁶

Figure 2: Stock of External Debt by Borrower Type and Maturity, 2000-2011



Source: World Bank Debtor Reporting System.

¹²⁶ World Bank/ IBRD (2013) 8.

Regarding the second point mentioned above, it is worth noting that the wording of the Belgian statute is clear and will effectively prevent lawsuits seeking to seize the specific property regulated, and this will be so as long as the property is situated within Belgian jurisdiction. In respect of developing funds, these are often headed out of the Belgian jurisdiction and it is possible that the funds may again become attachable when they arrive at their destination. It may also be questioned whether a court located outside Belgium will give any effect to the special status of assets earmarked for Development Cooperation and development aid under the Belgian statute, if a creditor seeks to seize the funds as they pass through another jurisdiction. The answer will no doubt vary from one jurisdiction to another, depending on the respective laws, and I will therefore leave the question open.

With respect to the third finding, it must be said that the design of the Belgian statute is quite general and is meant to cover all attachment claims over certain types of property, regardless of the basis for the sovereign debt claim. At the same time, the Belgian statute only protects state development funds and loans from attachment, and leaves all other property open to attachment in fulfilment of a sovereign debt holdout claim (except for property that is otherwise protected, see chapter 2.4). Further, the statute does not prevent minority creditors from holding out from restructuring processes, nor does it prevent holdout creditors from suing and obtaining a judgment on the merits confirming the creditor's right to the full amount under the original (non-restructured) loan agreement. During the legislative process, politicians argued that holdout creditors free riding on debt relief initiatives had to be stopped. The Belgian legislation protects property that is probably viewed by politicians and the population at large as amongst the most cynical assets to seize, but in fact protects only a small selection of property from attachment. More specifically, it prevents new funds for developing countries from being attached in fulfilment of a sovereign debt claim. In principle, it is still possible to free ride on the actual losses taken on by governmental and private creditors by attaching other kinds of property and by suing for the full amount under the original loan agreement in Belgian courts. Despite references to, and criticism of, holdout litigation and so called vulture fund activity in the law-making process, the statute itself does not address the broader challenge of creditors holding out from restructuring processes and ensuing litigation claims.¹²⁷

¹²⁷ On 6 May 2015, all major parties represented in the Belgian federal parliament signed a proposal for a new law. The aim is to provide a legal framework for avoiding 'illegitimate advantages' to holdout creditors. In the proposal an 'illegitimate advantage' is defined as a 'manifest disproportion between the amount claimed by the creditor and the notional face value of the debt'. The proposed law provides more criteria to clarify what constitutes an 'illegitimate advantage', such as whether the debtor was insolvent at the time of the debt buyback; if the creditor have a track record in litigation; whether the debtor took part in debt restructuring that the creditor refused to participate in; and what are the socio-economic impacts of reimbursement on the debtor. Due to the time limit of this thesis I will not have the opportunity to make this proposal a part of the thesis. See Van de Poel (2015).

3.2 The United Kingdom – Law Aimed at Preserving HIPC Debt Relief

3.2.1 The Backdrop

The UK government's commitment to granting debt relief to heavily indebted poor countries was reinforced after it chaired the G8 meeting in 2005.¹²⁸ The meeting culminated in the Multilateral Debt Relief Initiative (MDRI), which involved the International Development Association, the International Monetary Fund (IMF) and the African Development Fund cancelling US\$50 billion in debt to the world poorest countries that had completed (or would complete) the Heavily Indebted Poor Countries (HIPC) Initiative.¹²⁹

As a result of the international debt relief provided by the HIPC initiative and the MDRI, some creditors started taking advantage of the fact that certain debtor countries were now in a better economic position to pay off other debt obligations. These creditors commenced lawsuits against different HIPC countries claiming full repayment under the original loan agreements, as they stood prior to the HIPC debt relief. One such lawsuit took place in England in 2007, when a private investment fund called Donegal International sued Zambia, a low income country ranked 142th in the Human Development Index (in 2014).¹³⁰ The lawsuit was based on a US\$15.5 million debt contract dating back to 1979, concluded between Romania and Zambia, in connection with the purchase of agricultural equipment. In 1999, Donegal bought debt owed to Romania for the amount of US\$3.3 million. After first having reached an agreement with Zambia, the country defaulted again and Donegal commenced legal proceedings claiming full repayment of the debt plus interest totalling US\$55 million. In the final award, the High Court (UK) found this amount to be punitive and awarded US\$15.5 million, almost five times the amount the company had originally paid for the debt.¹³¹ A more recent case brought before UK courts by the Caribbean-based investment funds Hamas Investments and Wall Capital concerned holdout litigation against Liberia. Liberia had borrowed US\$6 million from US-based Chemical Bank in 1978. The investment funds pursued the debt through litigation and, in 2009 the High Court awarded the investment funds US\$20 million, an amount said to be equivalent to around 5 per cent of the country's national budget. In the same year, Liberia had benefited from a US\$1.2 billion debt buy-back through the World Bank at a 97 per cent discount on its face value. The two litigating investment funds were the only two private creditors who had refused to participate in the buy-back arrangement.¹³²

¹²⁸ Sookun (2010) 88.

¹²⁹ World Bank (undated) 2. For more information on the HIPC initiative, see page 2, footnote 22 of this thesis or: IMF (2015).

¹³⁰ United Nations Development Program (2014).

¹³¹ Debt Relief Bill (2010) 9.

¹³² *ibid* 9.

These lawsuits against sovereign debtors in UK courts raised awareness of the problem of aggressive holdout creditors and the business model of so-called vulture funds. British citizens, NGOs and politicians did not approve of the situation where holdout creditors made a profit out of the good will of other creditors who had taken a share of the losses the HIPC and MDRI debt relief initiatives actually entailed.¹³³

3.2.2 The legislation

3.2.2.1 Introduction

As a reaction to the creditor lawsuits mentioned above, the United Kingdom Parliament passed the Debt Relief (Developing Countries) Act in April 2010. The legislation was designed to ensure that all creditors provide their share of debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative.¹³⁴ The Government press release stated that the Act aimed to tackle ‘the problem of a small minority of creditors, often referred to as “Vulture Funds”, taking HIPCs [Heavily Indebted Poor Countries] to court to try to get back the full value of their debts, including interest and penalties for arrears’.¹³⁵ The Act had a sunset clause primarily introduced to review evidence of the impact of the legislation, but on 16 May 2011 the Act became permanent.

3.2.2.2 The Act

The specific debts regulated in the Act are called ‘qualifying debts’ and are defined in detail in sections 1(3) and 2. Qualifying debt encompasses public or publicly guaranteed debt that is external, and which the HIPC Initiative applies (or potentially applies) to. Qualifying debts must be incurred before the commencement of the Act and, if the HIPC initiative already applies to a country, the debt must have been incurred before the decision point of the HIPC process was reached.¹³⁶

According to section 3(1), read in conjunction with section 4 of the Act, the amount recoverable in respect of a qualifying debt, or in any cause of action relating to a qualifying debt, is the amount that would otherwise be recoverable if the debt were reduced in accordance with the HIPC Initiative. Sections 3(4) and 3(6) specify that the amount recoverable under a ‘compromise agreement’ or ‘rescheduled debt or a new debt’ agreement is also limited to the amount that would otherwise be recoverable if the debt were reduced in accordance with the HIPC

¹³³ See for example Wray (2010).

¹³⁴ HM Treasury (2011).

¹³⁵ *ibid.*

¹³⁶ Decision point is the time when the heavily indebted poor country has fulfilled the requirement laid down in the HIPC and may receive the final debt relief. The HIPC requirements roughly consist in implementing and following its ‘poverty reduction strategy paper’ and achieving a certain macroeconomic stability.

Initiative. According to section 3(8), the maximum cap on the amount recoverable also applies to the enforcement of any security. Section 3(9) notes that the cap on the amount recoverable outlined in section 3 also applies if the law applicable ‘to the qualifying debt, or to any compromise agreement, refinancing agreement or security, is the law of a country outside the United Kingdom’.

According to section 5(1), the Act applies both to judgments concerning HIPC debt handed down by a court in the UK before commencement of the act; foreign judgments handed down (whether before or after commencement) on a relevant claim; and awards made (whether before or after commencement) on a relevant claim in arbitration (conducted under any law). This means that the recoverable amount in cases where enforcement of foreign judgments and awards is sought within the UK is also subject to the maximum cap on recoverable funds, laid down in section 3 of the Act. To sum up, the Act regulates the total amount recoverable from a claim based on a contract conferred to the jurisdiction of UK courts (even if the law applicable is the law of a country outside the United Kingdom); the total amount recoverable under a claim based on a contract subject to UK law anywhere in the world; and the execution of a foreign judgment or award concerning HIPC debt within the UK.

3.2.3 The Assessment

The UK, and especially England, is a global financial centre and many sovereign credit contracts are subject to English law and confer jurisdiction to the English courts. With respect to sovereign bonds, approximately 48 per cent are subject to English law.¹³⁷ In addition, many foreign states have assets in or passing through the UK, so that they may be exposed to attachment in connection with the execution of a sovereign debt judgment in the UK. Changes in legislation that affect creditors’ incentives to participate in the restructuring of sovereign debt and to litigate sovereign debt claims, may therefore have a major impact on the system of sovereign lending and borrowing.

The UK Debt Relief (Developing Countries) Act encompasses court claims concerning original loan contracts, compromise agreements and restructured HIPC debts, which means that all these agreements are subject to the same maximum cap on recoverable funds. To ensure that the maximum cap is respected, the Act indirectly regulates (or moderates) the rights laid down in these lending agreements both where a claim is brought before a court within the United Kingdom (regardless of whether the law applicable to the contract is the law of a country outside UK law or not) and where enforcement of a sovereign debt judgment or award is sought within the UK jurisdiction. The UK Act only has direct effect inside UK jurisdiction. Howev-

¹³⁷ IMF (2014) 6.

er, the Act also affects the execution of a UK judgment in foreign jurisdictions. Taken together these features constitute quite a comprehensive approach, which makes it difficult for holdout creditors to circumvent the aim of the legislation.

The UK Act does not force creditors to participate in sovereign debt restructurings or debt relief directly, nor does it prevent one from bringing a sovereign debt claim. By putting a cap on the maximum amount recoverable for certain types of sovereign debt, the Act discourages holdout creditors from suing for the whole amount. Whether or not a creditor takes part in restructuring or debt relief, such as HIPC debt relief, a creditor will not be able to extract more money through a lawsuit than he would have been entitled to receive had he participated in HIPC debt relief. Thus, the Act makes it somewhat meaningless for creditors to commence proceedings in the courts of the UK, with respect to the defined types of debt. As a result, and in respect of HIPC debt, the Act will provide an incentive to participate in restructuring initiatives and grant debt relief, rather than to hold out from such proceedings and litigate for the full amount. It should also be mentioned that both the description of qualifying debt and the instructions on how to calculate the cap on recoverable funds is made clear and simple. This will probably keep the number of court cases down, because it seems unnecessary to further clarify the content of the legislation. Confirming this assumption is the fact that, to my knowledge, there have been no lawsuits in UK courts claiming full repayment of HIPC debts, since the Act came into effect.

The expressed aim of the Act was to ensure that the money freed up by debt relief in HIPC countries would not have to be spent on debt repayment to holdout creditors, but would instead be used for actual poverty reduction. Based on my assessment above, I will argue that the UK Act has been successful in reaching this goal. It does ensure that UK courts neither hand down, nor enforce, judgments allowing recovery against HIPCs on qualifying debts, exceeding the amount calculated as sustainable under the HIPC Initiative. However, if we look back at the argument used in the run up to the passing of the Bill and when announcing the Act, both parliamentarians and the UK government spoke in quite broad terms about the fight against the more general problem of holdout creditors and free riding. The UK Act is strictly limited to HIPC debts, other (restructured) debt burdens having been left out completely. There is, therefore, still a considerable risk of holdout creditors using UK jurisdiction to litigate for full repayment under the original terms of a non-restructured loan agreement. It is important to bear in mind that the HIPC initiative is a one-time solution which is now being phased out. Total estimated debt relief through HIPC and MDRI amounts to US\$112.5 billion.¹³⁸ In the meantime, new sovereign debt burdens are being taken on, and the total amount

¹³⁸ World Bank (2012).

of external debt in developing countries as of end 2013 was US\$5,506.4 billion. In Sub-Saharan Africa alone, the total amount was US\$367.5 billion.¹³⁹ Not all of these debt burdens are unsustainable; this figure does however suggest that there are debt burdens that may require restructuring in the future. For all these debt burdens, the UK Act provides no incentives to ensure that all creditors participate in debt restructurings or debt relief, when the majority of the creditors are willing to do so. This means that economic contributions granted in relation to debt relief (other than through the HIPC initiative) or sovereign debt restructurings in which the UK has participated, may still be ‘exposed’ to claims from holdout creditors. For all these other debt burdens, a holdout creditor may put pressure on the sovereign debtor to pay in accordance with the original loan agreement and/or engage actual court proceedings to obtain full payment. As explained earlier in chapter 3.1.3, no one likes to bear the cost of free riders. If holdout creditors subsequent to restructuring manage to collect on the original claim for all restructured debt burdens except from HIPC debt, the consequence may still be a decrease in the participation in debt restructuring and debt relief both from public sector creditors and from private creditors in general.

To sum up, the UK Act has succeeded in curbing aggressive litigation on HIPC debts in UK courts. However, the argument put forward by politicians promoting the Act - namely that it would put an end to creditor free riding – have not been fulfilled, since all debts except HIPC debts remains unregulated and thus open to litigation and execution.

Before proceeding to the next section, it is important to mention that sovereign bonds subject to English law often include so-called Collective Action Clauses (CACs). The CACs are not mandatory, but have been standard in sovereign bonds subject to English law for a long time.¹⁴⁰ CACs enables a majority (or a supermajority) of the bondholders to bind the minority to certain changes in the contract terms; typically to accept a restructuring or not. This does improve the incentives in the case of judgments on claims in general, but not the possibility of executing a judgment within the jurisdiction of the UK. A further examination of CACs will be provided in section 3.3 and 4.3.3.

¹³⁹ World Bank/IBRD (2015) 26. In addition, since the financial crisis, developed economies now have highest and perhaps most unsustainable debt ratios. Europe and Central Asia had US\$1,234.2 billion in external debt stock in 2013.

¹⁴⁰ Gulati & Weidemaier (2014) 5.

3.3 Euro Area - Mandatory Collective Action Clauses (CACs) in Sovereign Bonds

3.3.1 The Backdrop

Several European countries have experienced distressed economies with unsustainable debt levels over the past decade. The first and most grave incident in the euro crisis took place in Greece sometime after the crisis hit Wall Street in 2008. It was then revealed that the country had unsustainably high public expenditure, a poor system of tax revenues, a private sector vulnerable to economic cycles, and that the Greek economy (and especially the Greek government), had been financing its deficit through external borrowing.¹⁴¹ Shortly after the Greek crisis occurred, another crisis followed in Ireland, but the causes of the crisis were quite different. Irish banks had been financing a real estate bubble, and the bubble burst when Irish banks were unable to refinance their maturing international loans through the international financial markets. The Irish government bailed out almost the entire financial sector which put them in a situation of sovereign insolvency.¹⁴² Other countries, Spain and Italy in particular, followed suit, though again the crisis encountered had different origins. Spain ran a high deficit on its public administration due, among other reasons, to a troubled private sector and an insolvent financial system. Italy, on the other hand, had a sounder private sector but significant public debt.¹⁴³ By 2010, the financial stability of the European Union was severely threatened by escalating public debt burdens, and other countries' economies were in danger of being contaminated.

Within this context, the European Union felt the need to act, and on 28 November 2010, Eurozone Finance Ministers announced a number of policy measures intended to safeguard financial stability in the euro area. One such measure was the mandatory inclusion of standardised collective action clauses (CACs) in all new euro area government securities.¹⁴⁴ The use of CACs is a contractual technique designed to ease the coordination problems that may complicate the restructuring of sovereign bond debt and thwart the disruptive practices of holdout creditors. Implementation of mandatory CACs in the euro area was not directly provoked by restructuring problems. However, as just explained, during the financial crisis several European countries faced (and still face) serious debt distress and were in danger of having to restructure their debts. In such situations CACs can serve to rein in holdout creditors, who may constitute a significant obstacle to the success of the restructuring process. Another equally important objective behind the treaty was to ensure that EU countries would not have to bail

¹⁴¹ Tirado (2012) 1.

¹⁴² *ibid* 2.

¹⁴³ *ibid* 3.

¹⁴⁴ Euro Model CAC Explanatory Note (2011) 1.

out other EU countries. Instead, the idea was to create incentives for creditors to take part in restructuring.¹⁴⁵

The contractual nature of CACs implies that they are covered by private autonomy and that the terms are negotiable. However, with respect to sovereign bonds the terms are naturally set by the issuer. To ensure that euro zone countries implemented equivalent CACs in their sovereign securities, a binding international treaty between euro zone countries was drawn up. A standardised CAC,¹⁴⁶ including supplemental provisions,¹⁴⁷ was first developed and agreed by the Economic and Financial Committee on 18 November 2011. The commitment to include such CACs was thereafter included in the Treaty Establishing the European Stability Mechanism (ESM) signed on 2 February 2012 between the euro area Member States.¹⁴⁸ According to the ‘Report on the implementation of euro area Model Collective Action Clause (CAC)’, as of 1 January 2013, all euro member states have taken the necessary steps to include the model CAC in new issuances with a maturity of more than one year, as agreed in Article 12(3) of the ESM Treaty. The CAC has been implemented either by contractual incorporation through amended legislation or regulation.¹⁴⁹

3.3.2 The legislation - the euro area Model CAC

3.3.2.1 Introduction

According to Article 12(3) of the ESM Treaty, the euro area Model CAC applies to all new euro area government securities, with a maturity above one year. The article further states that the CACs must be implemented ‘in a way which ensures that their legal impact is identical’. In the following I will set out the main features of the Common Terms of Reference of the euro area Model CAC.

3.3.2.2 Majority restructuring provisions - modification of bonds in a single series

Section 2 of the euro area Model CAC sets out the terms and conditions for the modification of bonds. These modification provisions are majority provisions, which allow a defined percentage of bondholders to approve certain decisions by vote that will bind all holders of certain bonds. According to section 1(f) of the Model CAC, the word ‘modification’ refers to ‘any modification, amendment, supplement or waiver of the terms and conditions of the Bonds or any agreement governing the issuance or administration of the Bond...’. According to the same section, the Model CAC differentiates between ordinary modifications and more

¹⁴⁵ Bradley & Gulati (2013) 54.

¹⁴⁶ Euro Area Model CAC (2012).

¹⁴⁷ Euro Area Model CAC Supplementary Provisions (2012).

¹⁴⁸ Sub-Committee on EU Sovereign Debt Markets (2012).

¹⁴⁹ *ibid* 1.

profound modifications related to payment terms, such as the change of seniority or ranking of the bonds; the governing law; the principal amount; the date on which any amount is payable; the currency and place of payment; the issuer's obligation to make payments; and the release of any guarantee issued in relation to the bonds. These more profound modifications are referred to as 'reserved matters'. The list of modifications that must be considered as 'reserved matters', is constructed in a way that indicates that all modifications that do not form part of the list should be considered as a non-reserved matter.

The Model CAC includes two possible procedural paths to modify a sovereign bond: through the summoning of a bondholder meeting or by means of a written resolution, c.f. section 2.1 (a) and (b) respectively. Both procedures set out specific requirements for a qualified majority and for a quorum (the percentage of bondholders required to take a vote). In order to modify a reserved matter in relation to a single series of bonds, the consent of the Issuer is required and an affirmative vote of holder of not less than 75 per cent of the aggregated principal amount of the outstanding bonds 'represented at a duly called meeting of Bondholders'.¹⁵⁰ Alternatively, a written resolution must be signed by or on behalf of holders of not less than 66 2/3 per cent of the aggregated principal amount of the Bonds then outstanding.¹⁵¹ In addition, according to section 4.5(a), quorum requires that no less than 66 2/3 per cent of the outstanding principal amount of the affected bonds be present in order to transact any meeting at which Bondholders will vote on such a modification. The majority requirements in the euro area Model CAC for single-series modification of a reserved matter have been set at a level that ensures that any voting scenario needs the approval of at least a majority in principal amount of the affected bonds ($>75\% \times 66 \frac{2}{3} \% > 50\%$).¹⁵² According to sections 2.5 and 4.5(b) of the Model CAC, non-reserved matters require the approval of more than 50 per cent of the outstanding amount in a meeting where 50 per cent of the outstanding principal amount is present. In the case of a written procedure, the approval rate for non-reserved matters is also set at 50 per cent.¹⁵³

3.3.2.3 *Aggregation clauses - modification of bonds across several series*

The procedure described above is limited to the modification of one series of bonds. Section 1(d) of the Model CAC defines a 'series' as different tranches of debt securities that in relation to each other and to the original tranche of debt securities are 'i) identical in all respects

¹⁵⁰ A 'series' is defined as different tranches of debt securities that in relation to each other and to the original tranche of debt securities are 'i) identical in all respects except for their date of issuance or first payment date, and ii) expressed to be consolidated and form a single series, and includes the Bonds and any further issuances of bond.' See § 1. (d) of the Euro Area Model CAC (2012).

¹⁵¹ See the General Definitions in section 1 (h) of the Euro Area Model CAC (2012).

¹⁵² Euro Area Model CAC Supplemental Explanatory Note (2012) 2.

¹⁵³ See also Hofmann (2014) 400.

except for their date of issuance or first payment date, and ii) expressed to be consolidated and form a single series, and includes the Bonds and any further issuances of bond'. According to section 2.2, the Model CAC does also allow for *cross-series modification*. This means that modification voting is aggregated so that the bondholders of more than one bond series can decide whether to amend the bond terms collectively. According to section 2.2(a)(i), the modification of reserved matters requires the consent of the Issuer and the affirmative vote of no less than 75 per cent of the 'aggregate principal amount of the outstanding debt securities represented at separate duly called meeting of the holders of the debt securities of all the series (taken in the aggregate) that would be affected by the proposed modification'. Alternatively, a modification may be made by written resolution signed by the holders of not less than 66 2/3 per cent of the aggregate principal amount of all the series that would be affected by the proposed modification, cf. section 2.2 (a)(ii). According to section 2.2(b)(i) and (ii) respectively, such a modification also requires an affirmative vote of more than 66 2/3 per cent of the aggregate principal amount of the outstanding debt securities represented at separate duly called meetings of the holders of *each series* of the debt securities that would be affected by the proposed modification; or a written resolution signed by the holders of more than 50 per cent of the aggregate principal amount of the then outstanding debt securities of *each series* that would be affected by the proposed modification. According to section 4.5 of the Model CAC, the quorum requirement for a cross-series modification at a meeting is still 66 2/3 per cent of the aggregate principal amount of the outstanding bonds. In the case of a cross-series modification of a non-reserved matter, the quorum is 50 per cent of the aggregate principal amount of the outstanding bonds.

The Model CAC leaves it to the sovereign to decide whether to exercise the aggregation option that lies in the cross-series modification provision, and how many series to include in it. The Model CAC also allows for partial cross-series modification in section 2.4: If a proposed cross-series modification of a reserved matter is not approved across all series, but would have been approved in one series, or in only some of the series of affected debt securities, *this partial* cross-series modification will be approved. The issuer is required to notify the investors in advance of the conditions under which a partial cross-series modification will be effective.

3.3.2.4 *Disenfranchisement provision*

Section 2.7(c) of the euro area Model CAC contains disenfranchisement provisions that determine which bondholders are not entitled to vote in the modification proceedings described in the said Model CAC. According to section 2.7(c)(i) – (iii), bonds will not be taken into account for the calculation of quorums and majority voting if the bond is held by the issuer; by a department, ministry or agency of the Issuer; or by a corporation, a trust or other legal entity that is controlled by the issuer (or its subordinate agencies), in a situation where the

holder is in different ways controlled by, or under the instruction of, the Issuer or one of the underlying entities of the Issuer.

3.3.2.5 Facilitated Communication - Rules on Representatives and Bondholder Meetings

Section 3 of the Model CAC provides for a ‘calculation agent’ whose responsibility is to calculate whether a proposed modification has been approved in accordance with the requirements put forward in the Model CAC. This includes the calculation of the outstanding bonds not disenfranchised, and whether the required quorum and supermajority is reached. It is the issuer who, according to section 3.1, provides the information regarding outstanding amounts and disenfranchised bondholders.

The Model CAC includes mandatory rules for the organization of bondholders meetings. Section 4 of the Model CAC regulates the possibility for bondholders to call a bondholders meeting. Section 4.2 requires that bondholders shall meet at any time, at the request of the issuer or of bondholders holding at least 10 per cent of the outstanding principal.

3.3.2.6 Majority enforcement provisions (acceleration, litigation, moratorium)

The euro area Model CAC includes supplementary provisions that only come into effect if the relevant sovereign bond actually provides for certain features. Section 2 of the supplementary provision provides for so-called acceleration clauses. When a sovereign defaults on a single bond, this may trigger a default on the entire debt, even though the rest of the debt would normally mature in the future. This effect is called acceleration and is produced by a contract provision commonly found in international sovereign bonds. The acceleration clause in section 2.1 in the supplementary Model CAC provides that ‘holders of not less than 25 per cent of the aggregate principal amount of the outstanding [b]onds may . . . declare the [b]onds to be immediately due and payable.’ The acceleration can, according to section 2.2, be reversed through the support of more than 50 per cent of the aggregate principal amount of the outstanding bonds. Section 3 of the supplemental provisions contains a further limitation on individual holder action (a moratorium) on all bond claims, which prohibits bondholders from enforcing their claims under the bonds individually. This limitation only applies if the bond provides for bondholders to have a representative. If the bondholders in such a case have failed to enforce the claims collectively, the right goes back to the individual bondholder.

3.3.3 The Assessment

3.3.3.1 *The majority modification provisions*

The core of the euro area Model CAC is the ability, for a qualified majority of the bondholders, to bind the minority. If a qualified majority of the bondholders are able to come to an agreement, all bonds will be modified, thus binding any holdout creditors.¹⁵⁴ This makes it harder for lone or small groups of creditors to impede a course of action, such as a restructuring, that might benefit the group as a whole.¹⁵⁵ In other words, it is a tool to overcome the free-riding problem that occurs when the need to compromise one's claim diminishes because other bondholders compromise first.¹⁵⁶ The introduction of this majority provision may also effectively prevent litigation by holdout creditors after a restructuring deal has been reached with the majority of the creditors.

If a modification is based on votes in an *individual series* of bonds, the bondholders of other series may benefit from voting against a restructuring in the hope that the bondholders of other series will 'approve the restructuring, accept losses, and thereby improve the sovereign's financial situation'.¹⁵⁷ If bondholders in several series do the same, there is a risk that there will be no restructuring at all. One example of the inefficiency of single series CACs was a restructuring in Dominica in 2004. Another example is the Greek restructuring in 2012. In the latter case there was a relatively high concentration of bonds in the hands of certain creditors who managed to block the position in about half of the foreign law-governed bond series, thereby preventing the operation of CACs in those series.¹⁵⁸ Such blocking may, for inter-creditor reasons, 'undermine the incentives of other series to agree to the terms of the restructuring'.¹⁵⁹

The euro area Model CAC does not only provide for single series modification but also for *aggregated modification*. If the voting is aggregated, the bondholders of more than one bond series may decide whether to amend the bond terms collectively. An aggregated modification clause will treat bondholders of all affected bond series as a group, because the voting requirements will apply equally to them all. This will clearly improve the chances of binding holdout creditors. However, the second requirement in the provision regulating cross-series modification in the model CAC (section 2.2 (b)) still provides a veto right to each individual

¹⁵⁴ *ibid* 395.

¹⁵⁵ Weidemaier (2013) 326. *See also* Das, Papaioannou & Trebech (2012) 43. Furthermore, *see* IMF (2014) 16-18.

¹⁵⁶ Hofmann (2014) 395.

¹⁵⁷ *ibid* 402.

¹⁵⁸ IMF (2014) 18.

¹⁵⁹ *ibid* 18.

series of affected bonds. This means that the creditors within *each* series still have to accept the amendment, though with a lower qualified majority vote than that requires in the case of single series modifications. When there is a requirement that each series approve the modification, there is still a risk that a minority of the bondholders block a restructuring.

It can be argued that the possibility of *partial* cross-series modification may improve the overall outcome of a restructuring process. If the creditors in one series have managed to create a blocking position, this flexibility ensures that the remaining series will still be bound, only precluding the restructuring from going forward in the particular series where holdout creditors have obtained a blocking position. However, it may also be argued that the flexibility introduced by partial cross-series modification may operate as an incentive for creditors not to participate in a vote due to the risk that amendments may affect only some series of bonds.¹⁶⁰ For these reasons, it is difficult to conclude whether or not the possibility of partial cross-series modification will in fact improve the chances of a successful restructuring in practice.

In August 2014, the International Capital Market Association (ICMA) issued a new standard collective action clause for the terms and conditions of sovereign notes. These new standards are intended to facilitate future sovereign debt restructurings.¹⁶¹ One of the main features of the new ICMA standard is the use of so-called ‘single-limb’ voting procedures. This procedure requires a single vote calculated on an aggregated basis across all affected bond series, and no second vote within each series.¹⁶² In September of the same year, the IMF expressed its support for the use of such a ‘single limb’ voting procedure in CACs.¹⁶³ Both the IMF and ICMA recognize that existing CACs, where voting procedures are limited to single series or limited (‘two-limb’) aggregation clauses, are not sufficient to cope with the problem of hold-out creditors in restructuring processes.¹⁶⁴ The IMF has also stated that if a two-limb voting procedure, such as the aggregation clause in the euro area Model CAC, had been used in Greece’s case, ‘it is doubtful whether the large bond series that were falling due shortly after the exchange would have voted to participate in the exchange’.¹⁶⁵ Both organizations suggest that a single limb vote should provide that a restructuring becomes binding for all creditors on

¹⁶⁰ ICMA (2011) 7.

¹⁶¹ ICMA has around 460 members drawn from both the buy and sell-sides, made up of issuers (including sovereign issuers), primary and secondary market intermediaries, asset managers, investors and capital market infrastructure providers. Its activities include promoting best market practice through the development of standard documentation, which is normally sent to its membership for consultation before publication.

¹⁶² See IMF (2014-1). See also Aggregated CAC, Standard (2014).

¹⁶³ IMF (2014-1) and IMF (2014-2)

¹⁶⁴ IMF (2014-1) 18.

¹⁶⁵ IMF (2013) 29-30.

obtaining the support of 75 per cent of the total outstanding principal of aggregated claims.¹⁶⁶ The fact that two leading organizations within the area of international finance have concluded that there is a need for a single-limb voting procedure, is a strong indication that the single series voting and limited aggregation voting offered by the euro area model clause, may not be sufficient when it comes to ensuring satisfactory conditions for sovereign debt restructuring.

In this respect, the question arises whether the euro area Model CAC is designed to set a ‘minimum standard’, such that the euro countries may adopt the more restrictive ICMA standard CAC? The ICMA has stated that they want the revised standard CAC to be able to work alongside the euro area Model CAC.¹⁶⁷ In support of this view is the fact that the main aim of the euro area Model CAC is to ease the restructuring process. In other words, since the ICMA CAC is believed to improve the likelihood of obtaining successful restructuring, it may be argued that it is up to the euro countries themselves to choose whether or not they want to implement a single-limb voting procedure in accordance with the ICMA model. At the same time, the euro area Model CAC states that the CACs implemented in respective countries’ bonds should be identical. This may suggest that the stricter ICMA CAC cannot be implemented in euro countries. The legal situation does not seem to be settled. It would be unfortunate if the Treaty introducing the euro area Model CAC actually hindered implementation of the model CAC recommended by the IMF and the ICMA in the euro area.

3.3.3.2 Facilitated Communication and the role of bondholder representatives

The euro area Model CAC provides for a calculation agent, who is responsible for calculating the relevant numbers in voting procedures related to modification of the terms of a bond. This includes both calculations concerning which bondholders are entitled to vote during restructuring and the exact amount of outstanding bonds. Undisputable information is useful because it can increase the chances of a successful restructuring agreement by reducing conflict and easing voting procedures. However, the calculation agent in the model CAC has a relatively small role in the wider process of modification. For example, it is up to the issuer to provide the figures, which will serve as the basis for the calculation. Furthermore, the calculation agent is chosen by the issuer. This latter feature can be problematic for creditors if they doubt

¹⁶⁶ The IMF has taken into consideration the danger of abuse from majority voters. To ensure inter-creditor equality, both organizations have suggested certain safeguards. The safeguards will ensure that holders of a particularly large bond issuance cannot use their voting power to agree upon terms that discriminate against the holders of smaller issuances. The suggested safeguard will ensure that the issuer can only use the single-limb voting procedure if it offers all the affected bondholders the same instrument or an identical menu of instruments. See IMF (2014-1) 21.

¹⁶⁷ International Finance Law Review (2013).

the impartiality of the agent. Such suspicions may weaken the position of the calculation agent and result in a more difficult restructuring process.

Overall, the model CAC encompasses few features that facilitate communication between the bondholders and the issuer, and amongst the bondholders themselves. There are also very few measures aimed at facilitating communication between the parties engaged in a debt restructuring. As will be discussed in the next section, the supplementary provisions mention the possibility of appointing a bondholder representative with broader responsibilities than the calculation agent, but do not make such representation mandatory. The lack of regulations facilitating communication between the parties to a sovereign debt restructuring may be considered unfortunate. Through facilitated communication, solutions can be found before defaults occur and lawsuits may be avoided. In cases where the bondholders are numerous and dispersed, as is usually the case with today's sovereign bonds, it would be more effective to have one representative who 'aggregates the interests of a multitude of creditors, thereby facilitating matters for the sovereign while strengthening the bondholders' negotiating powers as compared to their relative individual insignificance'.¹⁶⁸ In their response to the consultation on the euro area Model Clause, the ICMA recommends that the model CAC 'fully provide for a bondholder representative in respect of relevant debt securities'.¹⁶⁹ The ICMA suggests that it is essential to have an entity with more responsibilities than a calculation agent, such as a fiscal agent or trustee or bondholder representative, if the bondholder meetings described in the Model CAC are to operate successfully.¹⁷⁰ The ICMA questions whether there is, under the current euro area Model CAC, a party responsible for 'performing all the relevant steps relating to the convening of meetings of bondholders including compliance with applicable voting procedures at meetings and compliance with the procedural steps related to the passing of a written resolution'.¹⁷¹ Furthermore, the ICMA fears that a calculation agent with limited responsibilities, as set out in the Model CAC, does not provide sufficient certainty or transparency to prevent challenges from bondholders.

To sum up, the existence of a calculation agent is a feature which may ease the restructuring process to a certain extent. As argued above the calculation agent in the Model CAC has very limited responsibility, and may prove to have a limited positive effect on the restructuring process.

¹⁶⁸ Hofmann (2014) 398.

¹⁶⁹ ICMA (2011) 6.

¹⁷⁰ *ibid* 8.

¹⁷¹ *ibid* 18.

3.3.3.3 *The majority enforcement provisions*

The supplemental provisions of the Model CAC open up the possibility of limiting sole holder action by requiring that a representative of the bondholders pursue all claims (litigation and enforcement attempts) collectively. Limiting sole bondholder action may have a positive effect on achieving a restructuring agreement, because it prevents single bondholders from upholding claims that are not in the interest of the majority. Furthermore, it promotes equal treatment of creditors and thereby contributes to preventing free riding. Clauses regulating bondholder representatives are frequent in Anglo-American law-based bond issuances. However, as mentioned in the previous section, the EU Committee decided not to make this a mandatory part of the euro area Model CAC. It can be argued that the inclusion of this clause is ‘recommended’ via its inclusion in the supplemental provisions. Since the practice in respect of bondholder representatives varies a lot within the civil law jurisdictions of Europe, the normative effect of the supplemental provisions is at least dubious.¹⁷²

The supplemental provisions of the Model CAC also include another provision concerning enforcement, namely an acceleration clause. This clause provides that when a sovereign defaults on a single bond, this may trigger a default on the entire debt (acceleration), even though the remaining debt would normally mature at a later date. According to the supplemental provisions, acceleration can only be triggered by a bondholders’ majority vote. In addition, it provides for the reversal of acceleration by majority vote with a lower threshold. Both by requiring a majority vote to initiate acceleration and by providing the possibility of reversing acceleration (rescission of acceleration), the provision is likely to have positive effects on the probability of reaching a restructuring agreement and so decrease the number of holdouts. In the case of a pre-default restructuring, the acceleration clause of the Model CAC may contribute in decreasing the chances of a mass default. The actual restructuring of a bond can take some time, and the sovereign debtor may default before a restructuring agreement is reached. If there is a requirement for a majority vote to accelerate a default on the entire debt, and there exists a possibility to undo the acceleration, this may help avoid a mass default; a snowball effect that could aggravate the financial situation of the sovereign even more. With the possibility of limiting the acceleration there will be less debt in actual default, which means fewer debt series to restructure, and fewer creditors to coordinate. As with the clause providing limitations on sole holder action, however, what weakens the acceleration clause is the fact that it is voluntary.

¹⁷² Tirado (2012) 18.

3.3.3.4 General scepticism towards CACs

CACs may also be criticised at a more general level. This criticism usually goes beyond the question of the effectiveness of the design of a specific CAC. The general criticism is linked to the fact that CACs represent a contractual and market-based approach. The argument is that this contractual approach does not go far enough and may constitute an obstacle to a more comprehensive and structural solution to the problem of minority holdout creditors.

First, it can be argued that majority voting provisions do not provide for sufficiently *comprehensive* restructuring. As described in section 3.3.3.1, a restructuring will become easier if the specific CAC includes a cross-series modification provision that applies a single-limb voting procedure. However, with thousands of creditors and many bonds with variable bond terms (different payment terms and maturities), it may still be difficult to create an exchange offer that the majority of the *different* bond issues will accept. A situation where there are thousands of small creditors (investors) is likely to create an atmosphere with fewer incentives to take an active choice and actually participate in a debt restructuring. In other words, the mere nature of investing in a modern sovereign bond may lead to a situation where it is less likely that creditors choose to take part in restructurings. Additionally, CACs do not provide any solution to the problem of minority holdout creditors for outstanding bond-debt where CACs have not been included. As of June 2014, the IMF has estimated that of the approximately US\$900 billion foreign law bonds outstanding, about 20 per cent do not include CACs. Of a total outstanding stock of New York law governed bonds of about US\$420 billion, about 25 per cent do not include CACs.¹⁷³ The problem of holdout creditors also continues to exist for outstanding non-bond debt, which does normally not include CACs. The long-term external debt owed by developing countries to private creditors amounts to US\$1041.7 billion, US\$818.0 billion of which is bonds and US\$223.7 billion of which is non-bond debt.¹⁷⁴

Second, it is argued that majority voting may leave the sovereign with *too much* debt. The argument is that ‘creditors will trade off the efficiency benefits of debt reductions against the costs in terms of reduced expected debt repayments’.¹⁷⁵ The consequence may be a debt restructuring procedure that is too creditor-friendly leading to inefficiently low debt forgiveness, and even an increased possibility that the debtor country will default again in the near future.

¹⁷³ IMF (2014-1) 17. To obtain this data, the IMF staff has relied on the Bloomberg and Dealogic databases, which may be subject to inaccuracies, and the assumptions that English and Japanese law-governed bonds all include CACs.

¹⁷⁴ World Bank/ IBRD (2015) 21.

¹⁷⁵ Hofmann (2014) 744.

Third, majority voting provisions may undermine an informal system of (absolute) priority that is common in the area of sovereign lending. This informal system of priority is important because, compared to corporate debtors, it is more difficult for sovereign debtors to offer collateral. Even when a sovereign debtor intends to provide security, it is quite demanding to actually succeed in enforcement. Due to the lack of effective collateral within the context of sovereign lending, states have often relied on differential repayment schedules and implicit priorities. Some academics fear that if debt restructurings are left to the market, ‘there is no way to guarantee that the parties’ agreed-on priorities will actually be respected if the sovereign encounters financial distresses’.¹⁷⁶ If creditors are afraid of losing such priority during a restructuring, it will be an incentive for them to hold out from such processes, increasing their chances of reaching a blocking position.

It should be noted that there is also another general criticism of CACs voiced by representatives other than those just mentioned: since CACs make it easier for a sovereign to restructure debt, lending costs will increase. Their argument is not focused on the effect of CACs on creditors’ participation in restructurings, and is hence less relevant to this thesis. It is however worth noting that recent research indicates that the presence of a CAC in a sovereign bond issue is associated with a lower cost of capital, especially for financially weak issuers. Further, the research finds that there is a ‘significant positive relation between spreads and the number of votes required to change the payment terms’.¹⁷⁷

3.3.3.5 Preliminary conclusion with respect to the euro area Model CACs

There are no international standard CACs, and the efficiency of a CAC is closely connected to the way it is drafted. Not all types of CAC are equally effective in solving the problems of minority holdout creditors and subsequent holdout litigation attempts. In the previous sections I have examined the features of the euro area Model CAC. Even though I have argued that some of its features are weak, I will nevertheless contend that the model CAC significantly enhances the overall prospects for successful restructuring.¹⁷⁸ The core features which contribute to easing debt restructuring are the provisions allowing for a super-majority of creditors to impose restructuring terms on minority holdout creditors. Additionally, the fact that the euro zone countries implement mandatory CACs in all sovereign bonds may contribute to setting a market standard and making it easier for developing- and emerging markets to implement

¹⁷⁶ *ibid* 744.

¹⁷⁷ Bradley & Gulati (2013) 53.

¹⁷⁸ For an empirical analysis of the economic effects of the euro zone CACs, see *ibid*. This article assesses the likely effect of this proposal on the borrowing costs of sovereign debtors. Contrary to much of the literature, the article finds that the presence of CACs leads to a lower cost of capital, especially for below-investment grade bonds.

CACs in their respective bonds. The concept of CACs has existed a long time, but the inclusion of the clause in sovereign debt contracts has usually been voluntary. Some sovereign debtors have not included CACs in their bonds because they are afraid that they are sending a message to the market that they are more likely to default than countries that do not include CACs in their bonds. Countries that do not have an AAA credit rating, in particular, may be afraid that investors do not want to invest in bonds with CACs. Legal scholars have argued that some investors may prefer sovereign bonds with contract terms that increase the likelihood of a taxpayer-funded bailout, in case the sovereign encounters financial difficulty. CACs are often seen as bailout substitutes and many investors may thus prefer sovereign bonds without CACs. However, as the same legal scholars have also pointed out, the fact that investors might not want CACs does not necessarily mean that official sector actors should refrain from attempting to influence bond contracts. On the contrary, in the article ‘Reforming Sovereign Lending Practices’ by Weidemaier, he points out that ‘encouragement, suasion, and other non-coercive methods often will fail to dislodge entrenched contracting practices’.¹⁷⁹ Based on an empirical study of contract change after both disruptive events and persuasive initiatives from the official sector, he further concludes that ‘change may require fairly assertive, official sector intervention’.¹⁸⁰ The treaty providing for the euro area model CAC is one such official sector intervention. The euro area Model CAC is an important step towards broader implementation of CACs because it includes a number of economically significant states. Additionally, it is important because when the euro area takes a leading role in implementing CACs, they show that even countries with quite solid economies (such as Germany) find it reasonable and affordable to introduce CACs into their sovereign bonds, making it easier for other countries to follow suit.

3.4 Preliminary conclusions with respect to legislative action

3.4.1 Comparative analysis

The three legislative initiatives presented in this chapter all seek to avoid what the respective legislators have perceived to be a challenge to a sound restructuring process: minority holdout creditors and creditors suing the sovereign debtor to obtain full payment under the original loan agreement. The three legal approaches do however vary quite a lot with regard to their content and effects. These differences are discussed below and demonstrated in figure 3.

The first obvious difference between the examined legislative initiatives is that they use different types of tools to achieve their goals, namely the introduction of ‘mandatory’ contractual provisions; immunisation of property; and the implementation of procedural limitations by

¹⁷⁹ Weidemaier (2013) 344.

¹⁸⁰ *ibid* 345.

putting a cap on certain money claims and the execution of certain money claims. This can be seen in the first row of the table.

Figure 3: Differences between holdout legislation

Legislation Characteristics	Belgium	The UK	Euro area countries
Type of tool	Immunisation of property, by statute	Statutory limitation on the enforcement of contractual rights	Contractual provision
Activation of the tool	After restructuring	After restructuring*	Before/ during restructuring
Relevance in case of litigation	Enforcement stage	Judgment on the merits & enforcement stage	Judgment on the merits
Jurisdictional reach	Enforcement of both national and foreign judgments and awards within Belgian jurisdiction	Judgments on the merits in UK courts (regardless of which law a contract is subject to); contracts subject to UK law; enforcement of national and foreign judgments and awards in the UK; enforcement of UK judgments in foreign jurisdictions	All jurisdictions
Type of debt included	All sovereign debt	HIPC debt	Sovereign bonds
General incentive for creditors to participate in restructurings	Limited effect	Strong effect for the type of debt included	Potentially strong effect

Another difference, shown in the second row of the table, is related to whether the legislation is meant to improve the chances that creditors will participate in restructurings, or whether it is meant to reduce the potential negative consequences of a restructuring with holdout creditors. This factor is connected to the question of the point in the ‘life cycle’ of a debt dispute

that the legislation meant to affect, which is further connected to the question of what role the legislation plays in litigation (see row three). The Belgian statute does not regulate the restructuring process itself, nor does it interfere with the possibility of a holdout creditor obtaining a judgment on the merits in general. The Belgian legislation prevents holdout creditors from seizing certain types of property by immunising official development aid and governmental loans. It focuses solely on the enforcement stage of the ‘life cycle’ of a sovereign debt dispute, after restructuring has taken place. The UK statute regulates situations in which debt restructurings has already taken place, and a holdout creditor seeks to obtain a judgment on the merits (a money judgment) or tries to enforce such a judgment. Compared to Belgian law, it therefore seems to have a broader approach. The euro area Model CAC seeks to resolve a debt dispute in its initial phase, before or during a restructuring. A CAC is implemented at the contracting stage, and is designed to facilitate coordination amongst creditors during restructuring. The goal is to ensure that there will be no holdout creditors in a future restructuring process, by enabling the majority to bind the minority. If a CAC works properly, this implies that a holdout creditor will not succeed in a claim for full repayment in a lawsuit against a sovereign debtor. For these reasons, CACs are likely to reduce the need for legislation regulating enforcement of a debt judgment (such as the Belgian statute).

The three legislative initiatives also differ as to their *reach*, or in other words, the extent to which they have effect outside their own jurisdictions (row four in the table). The Belgian statute immunises from enforcement measures both official development aid and governmental loans that pass through Belgium. This property is immune both when national and foreign debt judgments and awards are enforced within Belgian jurisdiction. It is however questionable whether the statute will have any effect if a holdout creditor tries to seize official development aid or governmental loans after it has passed through Belgian jurisdiction. It is also questionable whether foreign courts will attach much importance to the Belgian statute if a holdout creditor brings a lawsuit outside the Belgian jurisdiction. The UK Act regulates lawsuits within the UK, both where a holdout creditor seeks to obtain a judgment on the merits confirming its right to payment in accordance with the original non-restructured loan agreement (regardless of the law applicable to the contract), and when a holdout creditor seeks to seize property in fulfilment of such a judgment. The latter category of lawsuits also includes execution of foreign judgments and awards, which ‘expands’ the jurisdictional scope of the legislation. Furthermore, UK judgments enforced in foreign jurisdictions will also be limited by the same maximum cap laid down in the UK statute. The euro area Model CAC treaty requires that all euro area countries include a certain standard CAC in their sovereign bonds. Because CACs are contractual provisions, courts of all jurisdictions are in principle obliged to accept legitimate restructurings decided by majority bondholders. It is assumed that majority

voting provisions are accepted within most jurisdictions.¹⁸¹ The CAC- based approach can hence be said to be the most far reaching of the three legislative actions, when it comes to its impact in other jurisdictions.

The legislative initiatives examined encompass different types of debt and therefore different amounts of debt contracts (row five). The Belgian statute encompasses all intents of seizing developing aid or governmental loans, meaning that all types of debt contracts are potentially ‘protected’. The relevant debt under the UK statute is limited to HIPC debt, while the euro area Model CAC will be effective for all euro country sovereign bonds.

As the examination of each of the legislative initiatives has shown, I argue that they also vary as to the actual effect on creditors’ general incentives to participate in sovereign debt restructurings (row six). While the Belgian statute only immunises a small selection of property, holdout creditors are still free to attach all other kinds of property in order to enforce a holdout claim. Holdout creditors may still obtain a judgment reaffirming the right to payment in accordance with the original loan contract of a non-restructured debt, and attach all property except official development aid and official loans passing through Belgium. The Belgian approach may be described as ‘treating’ the symptoms of holdouts from restructuring, whilst creating little incentive of significance for creditors to participate in restructurings in the future. A holdout creditor litigating in the UK knows it is unlikely that he will obtain more via a lawsuit than what he would have received if the debt had been reduced in accordance with the HIPC initiative. Hence, the UK statute constitutes a strong incentive for holdout creditors not to pursue full payment for non-restructured debts, but instead to accept to participate in the debt relief initiative. All debts other than HIPC-debt however remain unregulated and open to litigation and execution within the UK. With respect to the euro area Model CAC, I argue that, even though some of its features are quite weak, it may significantly enhance the overall prospects for successful restructuring in the relevant countries. Because it includes a number of economically significant states, the Model CAC may also contribute to setting a market standard and encourage an increase in the use of CACs in sovereign bonds in the future.

Each of the three legislative initiatives covers a different area in which holdout creditors can impede the positive impact of a restructuring. As just described, the legal initiatives are, though to varying degrees, likely to have a positive impact on the outcome of sovereign debt restructurings. If one compares the general statements and condemnations of holdout behaviour made by politicians during preparatory work on legislation to the actual effects of the UK

¹⁸¹ This is both supported by the fact that the IMF, ICMA and the EU promote the implementation of CACs. See chapter 3.3.3.1.

and the Belgian legislation, the results seems quite limited. From a theoretical point of view, some of the negative consequences of creditors holding out from restructuring processes have indeed been corrected by these initiatives. However, there are still several ways in which creditors may succeed in holding out from restructuring and may subsequently use litigation to claim full payment, despite the enactment of legislation.

3.4.2 Empirical Observations

The analysis in chapter 3 has been mostly theoretical, examining the assumed effects of the three legislative initiatives when it comes to creditors' participation in sovereign debt restructurings. In the previous section I concluded that the relevant legislation in Belgium, the UK and the euro zone has not managed to curb all holdout behaviour by minority creditors in relation to sovereign debt restructurings. It may be asked whether there is actually a need for more comprehensive regulation to ensure creditors participate in restructurings and to prevent creditor law suits claiming full repayment in accordance with the non-restructured debt contract. Some would argue that there are still practical hindrances that constitute major obstacles for holdout creditors, preventing them from prevailing in sovereign debt disputes. As explained in chapter 2, the enforcement of creditor rights is in practice limited for two main reasons. First, sovereign debt is not normally backed by collateral and there may be a limited number of attachable governmental assets located outside national borders. Second, the principle of sovereign immunity, especially immunity from attachment, protects the assets of a sovereign even when the property is located in a foreign jurisdiction.¹⁸² Despite the gradual softening of the principle of sovereign immunity since the 1950s, the principle still complicates the execution of sovereign debt claims in practice. For these reasons, the 'holes' in the discussed legislation may not be decisive for an actual holdout creditor seeking full payment of non-restructured debt via a lawsuit. In the following section I will discuss some empirical evidence which sheds light on the question of whether there is a need for further regulation to ensure that more creditors participate in sovereign debt restructurings and to prevent creditors from bringing subsequent lawsuits to obtain full payment under the original loan terms.

A paper by Das, Papaioannou and Trebesch examines sovereign debt restructurings between 1950 and 2010 through a literature survey, data and stylized facts.¹⁸³ They find that '[d]ebt renegotiations have become quicker and less disputed since the 1980s and 1990s'.¹⁸⁴ Further, they find that most bond restructurings in the last 15 years have been relatively smooth: the re-

¹⁸² See also Das, Papaioannou, Trebesch (2012) 50.

¹⁸³ *ibid.*

¹⁸⁴ *ibid.* 6. The article is based on a new dataset by Trebesch, which is the first data collection to document all sovereign restructurings of external debt between 1950 and 2010, including both Paris Club agreements and debt exchanges with commercial creditors.

structuring agreements were implemented within one or two years and creditor participation exceeded 90 per cent. The two main exceptions to this tendency are the Argentina case in 2005 and the Dominica case in 2004.¹⁸⁵

Regarding creditor *litigation* against debtor governments, the paper states that ‘runs to the courthouse’ are widely regarded by scholars as the main obstacle to sovereign debt restructurings and debt relief initiatives in low-income countries.¹⁸⁶ According to the IMF and the World Bank, the volume of claims filed against HIPC countries alone has surpassed US\$2 billion, which is higher than the volume of debt relief that should have been provided by commercial creditors to these countries. Some of the claims filed account for a considerable share of GDP and the government’s annual budget. The paper further refers to a new comprehensive database tracking all creditor litigation within the sphere of sovereign debt. Firstly, the data indicates that most sovereign debt litigation has little to do with defaults or restructurings and is more often related to other types of government liabilities (i.e. unpaid energy bills or trade invoices). Second, the data shows that the number of default-related lawsuits in New York and London has increased since the 1980s and more than half of all default-related cases were initiated after the year 2000.¹⁸⁷ At the same time the paper clearly shows that the overall number of cases is rather small: between 1980 and 2010, 109 cases were filed against debtor governments in connection with a default on sovereign bonds or loans.¹⁸⁸ Figure 4, on the next page, shows the distribution of cases across time.¹⁸⁹

To sum up, there has been an increase in default-related creditor litigation. At the same time, the overall number of these cases is still quite low. Furthermore, the number of sovereign defaults and restructurings has gone down in the last ten years. The time spent on each restructuring is also quite low. This indicates that the contractual, market-based approach with voluntary restructurings has worked reasonably well in securing creditor participation and avoiding protracted negotiations.¹⁹⁰ With respect to the three legislative initiatives examined in this thesis, it can be said that they all contribute to solving specific problems that have occurred in the different countries (and areas). Based on the empirical evidence presented in this section, and despite holes in the relevant laws of Belgium, the UK and the euro area, one may argue that holdouts and subsequent litigation do not constitute a problem of significance. As all reg-

¹⁸⁵ Their analyses are based on the experiences of developing countries and they highlight the fact that their findings may not therefore apply to advanced economies or to countries with large, interconnected financial systems. Their dataset is of debt restructurings up until 2010 and does not include the Greek restructuring.

¹⁸⁶ Das, Papaioannou, Trebesch (2012) 50.

¹⁸⁷ *ibid* 50-51.

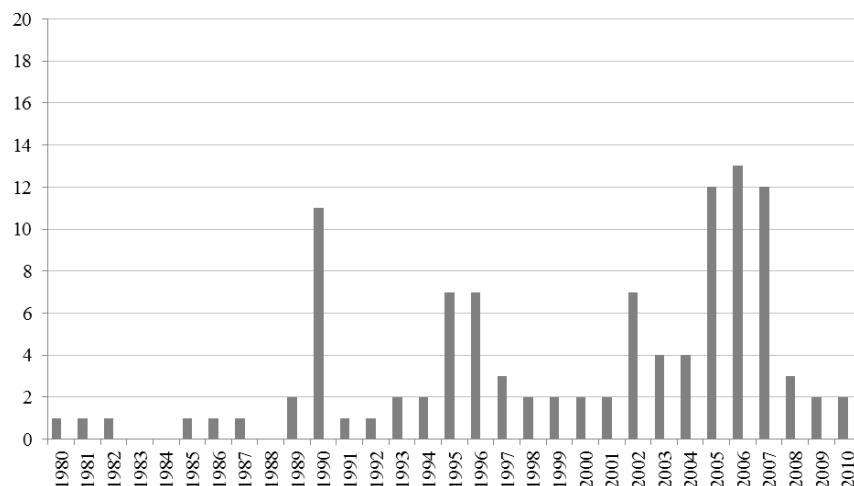
¹⁸⁸ *ibid* 50-51.

¹⁸⁹ *ibid* 51.

¹⁹⁰ *See also* IMF (2013) 26-27.

ulation comes at a cost and may have unintended effects, it may not be desirable to introduce further regulation to improve the incentives to restructure and prevent holdout litigation.

Figure 4: Creditor Litigation after Defaults/Restructurings: New Cases Filed per Year



‘The figure shows the number of initiated creditor litigation cases against debtor governments for each year between 1980 and 2010. Only lawsuits relating to sovereign bonds or loans are considered and only those filed in the United States and the United Kingdom. The spike in 1990 is due to the large number of cases initiated against Peru in the run-up to its Brady deal [a restructuring agreement], while the increase in case numbers after 2001 relates to the dozens of lawsuits following Argentina’s default’.¹⁹¹

The theoretical analysis and empirical evidence upon which I have based my conclusions in chapter 3, are based on the situation as it was until the year 2010. In the next chapter I will examine more recent episodes that have led to new legal developments, which may give rise to concern about potential collective action problems amongst creditors that could hamper future restructurings.

¹⁹¹ *ibid* 51.

4 New legal developments - Future challenges in the wake of the 2001 Argentine default

In this chapter, I will present recent legal developments within the sphere of sovereign debt litigation, which have arisen in the aftermath of the 2001 Argentine defaults. I will focus on the outcome of litigation before the Second Circuit District Court of New York (the District Court) and the International Centre for Settlement of Investment Disputes (ICSID) in *NML Capital, Ltd. v. the Republic of Argentina* and *Abaclat and Others v. Argentina*.¹⁹² My aim is to examine whether the outcome of these cases may have an impact on 1) the future participation of creditors in sovereign debt restructuring and 2) the effectiveness of the legislation examined in chapter 3, when it comes to handling holdout problems. In relation to the first dispute, I will discuss two legal outcomes in particular, namely the content of the District Court's novel interpretation of a *pari passu* clause in sovereign debt contracts and the court's issuance of an injunction in connection to the *pari passu* payment order. Concerning the ICSID proceedings, I will examine the possible consequences of ICSID accepting jurisdiction over a sovereign debt dispute for the first time. Before turning to the actual legal outcomes of the legal proceedings, I will start by presenting the background to the disputes arising from the Argentine default.

4.1 The background to the Argentine sovereign debt litigation

In 2001, Argentina suffered a major economic crisis and defaulted on its external debt payments. A great portion of these debts stemmed from bonds issued in the 1990s and were governed by the Fiscal Agency Agreement (the FAA).¹⁹³ In 2005 and 2010, Argentina managed to get the holders of some 93 per cent of the bonds governed by the FAA to agree to exchange their bonds for new ones. When accepting this agreement, the exchange bondholder had to forego between 71 per cent and 75 per cent of the principal payable under the FAA Bonds. Approximately 7 per cent of the holders of FAA Bonds declined to accept the bond exchange. These holdout creditors consisted of hedge funds and other distressed asset investors who had purchased the FAA Bonds on the secondary market, often at a steep discount, at various points in time up until June 2001.¹⁹⁴ Argentina continued to make payments to the holders of the Exchange Bonds but did not make any payments to those creditors still holding the defaulted FAA Bonds. In fact, Argentina passed legislation (the 'Lock Law') which imposed a temporary moratorium on the original FAA Bonds prohibiting the government from repaying the holdout creditors.¹⁹⁵

¹⁹² *NML Capital, Ltd., v. Republic of Argentina* (7 Dec. 2011). *Abaclat and Others v. Argentine Republic* (2011).

¹⁹³ The FAA (1994).

¹⁹⁴ *NML Capital, Ltd., v. Republic of Argentina* (26 Oct. 2012) paragraph 15.

¹⁹⁵ Ley N°26.017 (2005).

Later, in proceedings brought before various instances all over the world, the holdout creditors tried to attach Argentine property in order to satisfy the payments due and unpaid. The most notorious cases are probably connected to the investment fund NML Capital's attempt to seize a military vessel in Ghana and the airplane of Argentina's president.¹⁹⁶ As I will discuss in the following sections, the outcome of two sets of proceedings stemming from the Argentine default may have a major effect on future sovereign debt restructurings. One case has its origin in a New York District Court and the other is currently taking place in the International Centre for Settlement of Investment Disputes (ICSID).

4.2 NML Capital, Ltd. v. the Republic of Argentina: the *pari passu* clause and the corresponding injunction

4.2.1 Introduction

A subset of the holdout creditors from the Argentine restructurings, led by NML Capital, brought proceedings against Argentina in the court of the Southern District of New York (the District Court), with principal and past-due interest claims. According to the Fiscal Agency Agreement (FAA), the bond contracts were to be governed by the laws of the State of New York and any action brought by a bondholder arising out of or based on the bonds or the FAA was conferred to the jurisdiction of the courts of New York City.¹⁹⁷ On 7 December 2011, the District Court issued a summary judgment in favour of the claimant NML Capital. The court held that Argentina had violated the Equal Treatment Provision (the *pari passu* clause) of the FAA, by lowering the rank of the plaintiffs' bond 'when it made payments currently due under the Exchange Bonds, while persisting in its refusal to satisfy its payment obligations currently due under [the plaintiffs'] Bonds' and second when it enacted the 'Lock Law', which made it illegal to make payments to the holdout creditors.¹⁹⁸ On 23 February 2012, this judgment was amended with a reaffirming order stating that, according to the *pari passu* provision in the FAA, Argentina was obliged to make a 'rateable payment' to the plaintiff NML Capital whenever it paid any amount due on the Exchange Bonds.¹⁹⁹ The prevailing argument was that contracts have to be upheld to secure trust in the financial market in general and to secure trust in New York as a jurisdiction which respects and upholds financial agreements. Anticipating that Argentina would refuse to comply with the payment order, the District Court also issued an injunction prohibiting 'all parties involved, directly or indirectly, in advising upon, preparing, processing, or facilitating any payment on the Exchange Bonds' without also mak-

¹⁹⁶ Fontevecchia (2012).

¹⁹⁷ The FAA (1994) as described in *Knighthood Master Fund Lp v. The Bank of New York Mellon* (2014) para. 1-3.

¹⁹⁸ *NML Capital, Ltd., v. Republic of Argentina* (7 Dec. 2011) 10.

¹⁹⁹ *NML Capital, Ltd., v. Republic of Argentina* (23 Feb. 2012).

ing a ‘Rateable Payment’ to NML Capital.²⁰⁰ The District Court further confirmed that the indenture trustee and third-party financial intermediaries could face contempt of court if they were to process prohibited payments made by Argentina on the restructured bonds. Argentina appealed both the interpretation of the *pari passu* clause and the issuance of the injunction to the Second Circuit, and later to the Supreme Court. In October 2013 and in June 2014, the Supreme Court refused to hear Argentina’s appeals without any comment, thereby rendering the lower court’s decision final.²⁰¹

Ever since the restructuring of Argentina’s debts, the country had respected its payment obligations towards its exchange creditors. On 16 June 2014, Argentina transferred approximately €225.9 million to an account that the trustee of the euro denominated exchange bonds, the Bank of New York Mellon (BNY Mellon), held with the Banco Central de la Republica Argentina in Argentina.²⁰² Due to the District Court’s injunction, BNY Mellon did not forward to the bondholders the payment due on 30 July 2014, which again triggered a default on Argentina’s performing debt. Argentina still refuses to repay the holdout creditors and has still not managed to pay the amounts due to the exchange bondholders.

4.2.2 The Pari Passu Clause

The *pari passu* clause which the District Court interpreted in *NML Capital, Ltd. v. the Republic of Argentina* is a standard clause in both public and private international unsecured debt obligations.²⁰³ *Pari passu* is Latin for something close to ‘on equal footing’. At a general level it can be said that the clause is meant to secure the equal treatment of creditors. The specific content of the clauses, especially in sovereign debt contracts, has for a long time been examined and debated by academics, without the different actors coming to an agreement. The District Court’s interpretation of *pari passu*, which will create precedent within US law, gives holdout creditors a right to be paid at the same rate, relative to the respective debt obligations, and at the same time as those who have accepted to reschedule. The judgment order does not state that Argentina has an obligation to pay its creditors at a certain time, but rather that Argentina must pay the holdout creditors *if* it pays the creditors who have accepted the restructuring.

Pari passu clauses in sovereign debt contracts subject to US law now ensure that restructuring creditors have no right to priority over holdout creditors, when it comes to actual payment. The US *pari passu* interpretation gives holdout creditors a stronger right to fulfilment of their

²⁰⁰ *ibid* para. 2 e and 2 f.

²⁰¹ IMF (2014-1) 9.

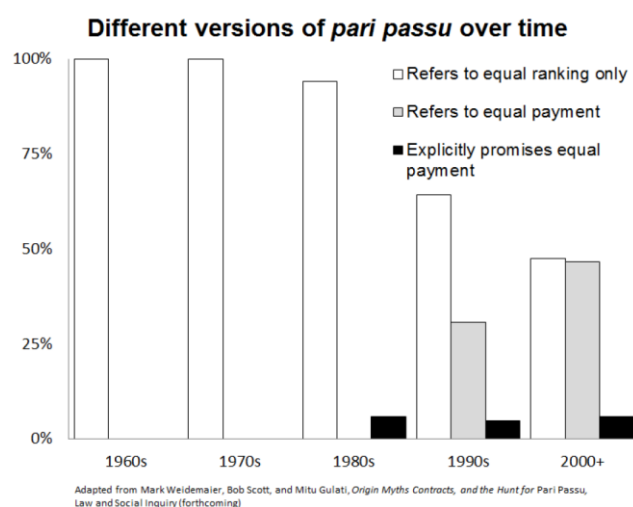
²⁰² *Knighthood Maser Fund Lp v. The Bank of New York Mellon* (2014) para 11.

²⁰³ Olivares-Carminal (2013) 121.

original (non-restructured) contract claims and may therefore increase the incentives for minority creditors to hold out from sovereign debt restructurings. Furthermore, the servicing of debt obligations is dependent on the sovereign debtor's limited resources. This may lead to a situation where the restructuring creditors have to accept a poorer restructuring agreement (bigger losses and lower payments further into the future) because the sovereign debtor must also have sufficient funds to repay the original claims of holdout creditors. Such a situation clearly constitutes a disincentive for creditors to take part in restructurings in general. For the sovereign borrower, the interpretation of the *pari passu* clause also has another negative effect: if sovereign borrowers must repay all creditors, including holdout creditors, in accordance with the rateable payment formula, this may imply bigger cuts in their own national budgets. Additional cuts may be suboptimal both for the sovereign debtor, the holdout- and the restructuring creditor, considering the state's chances for economic growth and crisis resolution.

Figure 5 below shows that the language used in the Argentine *pari passu* clause, or functionally similar language, has become more common, especially since the 1990s.²⁰⁴ The figure is based on a sample of bonds issued in foreign capital markets and governed by foreign law. The figure divides *pari passu* clauses into three categories: 1) clauses that seem only to promise that the issuer will maintain the equal ranking of its bonds; (2) clauses, like Argentina's, that imply an equal payment obligation; and (3) clauses that contain an explicit promise of equal payment. Almost half of the bonds issued after 2000 included the language found in the Argentine bond, which highlights the potential significance of the *NML Capital, Ltd. v. Argentina* for other bond issuances.

Figure 5: Different versions of *pari passu* over time



²⁰⁴ Weidemaier (2013) 11.

4.2.3 The Injunction

There may be a legal right to the property of a sovereign debtor, for example in fulfilment of a debt obligation, but it may nonetheless be difficult to execute the property in practice. In sovereign debt disputes, immunity from attachment often constitutes a practical obstacle to creditors seeking to execute a money judgment (see sections 2.4.4 and 3.3.3.5). The District Court's interpretation of *pari passu* may strengthen creditors' legal rights. It is however another question altogether to ask whether or not these legal rights will be effective in practice. The injunction issued by the District Court in *NML Capital, Ltd. v. the Republic of Argentina* forbids all parties involved from contributing, either directly or indirectly, to facilitating any payment on the Exchange Bonds without also making a 'Rateable Payment' to NML Capital.²⁰⁵ This injunction, issued to *enforce* the payment obligation in accordance with the *pari passu* clause, may prove to be just as important as the new interpretation of the *pari passu* clause, when it comes to strengthening holdout creditors' rights.

The District Court's injunction in the NML case comes after years of attempts by the holdout creditors to seize Argentine property, which have mainly failed due to the rules on sovereign immunity. The injunction formulated by the District Court seeks to enforce the *pari passu*-order using the 'help' of third parties involved in the process of paying the bondholders that have accepted the restructuring. An ordinary outstanding money judgment against a sovereign debtor, without the support of the injunction described, will often commit the debtor country to a constant stream of legal fees and evasive manoeuvres to avoid seizure of its property, so as to accomplish external diplomatic, military, and commercial objectives. Outstanding money judgments may also prevent the sovereign debtor from borrowing money on the financial markets.²⁰⁶ The use of the injunction in connection with a *pari passu* payment order will not necessarily hinder a sovereign debtor from accessing the credit market. Neither will it hinder states from engaging in commercial transactions in the way the immunity rules do when a sovereign debtor tries to avoid ordinary enforcement of a money judgment. The injunction issued by the District Court will rather impair the sovereign debtor's ability to service existing restructured debt, because no bank, trustee or other financial intermediary will help execute the payment when it falls due. Furthermore, by 'using' third parties to force the sovereign debtor to comply with the payment order, the injunction is not affected by the rules on sovereign immunity. If the sovereign debtor does not comply with the payment order, the result will be that the sovereign debtor defaults on its payment obligations with regard to the creditors who actually accepted the restructuring agreement in the first place. This is what happened in Argentina's case in August 2014. For these reasons, the consequences of the in-

²⁰⁵ *NML Capital, Ltd., v. Republic of Argentina* (23 Feb. 2012) para. 2.

²⁰⁶ Weidemaier & Gelper (2013) 26-27.

junction can prove to be just as costly as not complying with a money judgment itself.²⁰⁷ The injunction provides a powerful tool because the sovereign debtor is faced with the alternative of obeying the court order or not paying the exchange creditors, which can have potentially huge disruptive consequences for the economy of a sovereign debtor.

The next question is how the use of this type of injunction in connection with sovereign debt judgments may affect the incentives for creditors to participate in debt restructurings. Regarding the 2012 proceedings in *NML Capital, Ltd. v. The Republic of Argentina*, Professor Stephen Choi from New York University Law School was asked to give an opinion on the possible consequences of the District Court's interpretation of the *pari passu* clause and its February 2012 injunction.²⁰⁸ Amongst other subjects, he commented on the judgment and the injunction's effect on the ability of sovereigns facing financial distress to restructure their sovereign debt.²⁰⁹ In short, Choi concludes that the opinion of the District Court and its injunction 'materially increase the risk of non-payment for the Exchange bondholders'. This is in line with the examination in the previous section. Choi further concludes that the legal opinion 'materially undermines the ability of sovereigns in financial distress to engineer value-increasing debt restructurings that would benefit the sovereign and the group of all sovereign debt holders'.²¹⁰ With respect to the effects on participating creditors, Choi further notes that, instead of being rewarded for their sacrifice in 2005 and 2010 when they turned their bonds in for the Exchange Bonds and took a large 'haircut' in value, the Exchange bondholders face an increased risk of non-payment because of the *pari passu* order and the February 2012 injunction.²¹¹

Two English judges have, in a case before English courts, also commented on the effects of the same injunction issued by the New York District Court in relation to the *pari passu* payment order.²¹² The Bank of New York Mellon (BNY Mellon), as trustee for the holders of the Argentine exchanged Eurobonds, was one of the parties subject to the US District Court's injunction. BNY Mellon was, as previously mentioned, forced to withhold payments due in July 2014, which the Euro Bondholders are entitled to receive under their bond contracts. The complicating factor in this case is that when Argentina issued new bonds in exchange for the defaulted bonds, some were denominated in US dollars, others in Argentine pesos, and others

²⁰⁷ *ibid* 27.

²⁰⁸ Stephen Choi is a Bring Professor of Law at the New York University Law School, with a J.D. from Harvard Law School (1994) and a Ph.D. in Economics from Harvard University (1997).

²⁰⁹ Choi, Declaration (2012).

²¹⁰ *ibid* para. 7.

²¹¹ *ibid* para. 14.

²¹² The cases are *Knighthead Maser Fund Lp v. The Bank of New York Mellon* (2014) and (2015).

in euros. The euro-denominated bonds in this issue were to be governed by English law and Argentina irrevocably conferred these securities to the jurisdiction of the Courts of England. The Eurobond holders therefore sought a declaration in English courts stating that a foreign court's order [the US District Court's injunction] could not modify a contract governed by English law.²¹³ They argued that the US injunction should not be a legitimate excuse for BNY Mellon to actually withhold payments due under the English contract between BNY Mellon and Euro Bondholders. The declaration was denied by the English court on the grounds that it would serve 'no useful purpose'. As the court stated, the declaration would amount to little more than 'a declaration that the trustee would be in breach of trust unless it had a defence'.²¹⁴ However, as mentioned, both of the judges handling the case made some interesting comments with respect to the consequences of the US District Court's injunction and its effect on third party creditors (such as those who had accepted the Argentine restructuring):

'... the present position is rather unfortunate, albeit explicable by the understandable concern of the United States Courts that their [payment] orders should be obeyed: the bondholders (who, or whose predecessors, will already have had to agree to take far less than the face value of the FAA Bonds that they will once have held) would be liable to be prevented indefinitely from obtaining access to money that had been due to them contractually and to which they would now be beneficially entitled.'²¹⁵

One of the judges, Mr. Justice Newey, here raises a concern about the fairness of the New York District Court's injunctive measures with respect to the creditors who have accepted the restructuring and have already participated in the losses arising from the Argentine default in 2001. His stated concern is in line with the analysis of Professor Choi, who argues that the District Court's injunction makes future repayment more uncertain for exchange bondholders. The choice of accepting a restructuring offer normally consists in accepting some loss (bonds with lower value) in exchange for getting paid in the near future. Accepting a restructuring agreement is not usually associated with the risk of not getting paid at all, or only getting paid if the holdout creditors receive full payment. However, if minority holdout creditors can effectively hinder the fulfilment of an agreement between exchange bondholders and sovereigns issuing bonds, the chances that a creditor will accept the losses associated with a restructuring are rather low. If the type of injunction issued by the New York District Court becomes standard in sovereign debt disputes, it is reasonable to assume that this will make it less attractive for creditors to actually take part in and accept a restructuring agreement.

²¹³ *Knighthood Maser Fund Lp v. The Bank of New York Mellon* (2014).

²¹⁴ *Knighthood Maser Fund Lp v. The Bank of New York Mellon* (2015) para. 49.

²¹⁵ *Knighthood Maser Fund Lp v. The Bank of New York Mellon* (2014) para. 18.

When discussing the New York District Court's interpretation of the *pari passu* and the injunction's effect on debt restructuring processes in general, it is important to bear in mind that this interpretation is obviously not *binding* for courts in other jurisdiction. It is not given that courts outside the USA will follow this interpretation in their own cases. For example, the comments made by the English judges may indicate that English courts are unlikely to interpret the *pari passu* clause as the New York District Court has done in future cases, nor are they likely to implement an injunction that affects the contractual rights of third parties to the same extent. However, many debt contracts in general, and as many as 40 per cent of all international sovereign bonds, are subject to the jurisdiction of New York.²¹⁶ The interpretation of the *pari passu* clause and the use of the corresponding injunction have now created a certain precedent within the USA and this may have profound effects on future sovereign debt disputes.

Based on the foregoing discussion, I argue that the new interpretation of *pari passu* and the corresponding injunction provide a strong new tool for holdout creditors and constitute an incentive for creditors to holdout from sovereign debt restructurings. An objection to this view may be that it is too early to predict the long-term consequences of *NML Capital, Ltd. v. The Republic of Argentina*. As some have pointed out, the Argentine case is quite exceptional in that few sovereigns have the guts to pursue litigation for over a decade. On the other hand, the formulation of the *pari passu* clause that was the basis for litigation in this case is common in current outstanding sovereign debt contracts (see figure 5 in section 4.2.2).²¹⁷ Furthermore, in the aftermath of the injunction issued in the NML Capital case, at least one copy-cat lawsuit has been brought by Taiwan to collect on Grenada's defaulted debts. This happened only six months after the Second Circuit's ruling and could be an indication of what is to come.²¹⁸ There may therefore be reason to believe that market actors also consider these legal developments as effective tools for holdout creditors.

4.2.4 The effect on the examined legislation

I have just concluded that the novel interpretation of the *pari passu* clause combined with the far-reaching injunction provides a potentially strong tool for minority holdout creditors who seek full repayment in accordance with the original (non-restructured) loan agreement. I will now examine whether these legal outcomes will have any effects on the previously examined legislation from Belgium, the UK and the euro area.

²¹⁶ IMF (2014) 6.

²¹⁷ Weidemaier & Gelpern (2013) 4.

²¹⁸ *ibid* 5.

In Belgium, certain types of property have been protected (immunised) through national legislation. The injunction issued in connection with the *pari passu* payment order is a means of forcing the debtor country to accept the court order and pay the money claim. When a *pari passu* payment order operates in cooperation with the type of injunction issued by the District Court, there is no need for a holdout creditor to seize any property in fulfilment of a payment claim. The *pari passu* clause and the injunction do not interfere with rules on sovereign immunity from enforcement, which means that the specific funds immunised in Belgium will still be untouchable, and that the Belgian legislation remains intact. At the same time, the incentive to hold out from debt restructurings has increased as a result of the *pari passu* interpretation and the use of the corresponding injunction, and the Belgian legislation will not be able to curb this development.

The UK legislation puts a cap on funds recoverable on claims concerning so-called Heavily Indebted Poor Countries (HIPC) debt. UK courts are obviously not bound by the precedent set in US courts regarding the interpretation of the *pari passu* clause or the use of the broad injunction. Furthermore, as described in section 4.2.2, there is reason to believe that English courts will not interpret the *pari passu* clause in the same way as the New York District Court did. The District Court's interpretation of the *pari passu* clause may however affect the effectiveness of the UK Act in cases where enforcement of a US sovereign debt judgment is sought within the UK. The execution of a US judgment in the UK has to be done in accordance with the relevant law on civil procedure, including potential obligations pursuant to treaties between states on the enforcement of judgments from other jurisdictions, and the Debt Relief (Developing Countries) Act. It is possible that there may be an internal inconsistency between these two sets of rules. It is beyond the scope of this thesis to go into this question, but what can be said is that the solution in case of such a conflict will depend on the hierarchy of rules in the laws of the United Kingdom. For now, I will draw the simplified conclusion that execution within the United Kingdom of a US judgment concerning a debt claim based on a *pari passu* interpretation, may be moderated or restricted by the Debt Relief (Developing Countries) Act.

As explained in chapter 3, the UK Act does apply to enforcement in the UK of awards and foreign judgments handed down in other jurisdictions, and these awards and judgments may only be enforced for the reduced amount.²¹⁹ Imagine a situation where a creditor seeks enforcement of a *pari passu* payment order from a US court in the UK. The payment order concerns a non-restructured HIPC debt. UK courts will provide the holdout creditors with their share of the payments on outstanding debts, and these payments will be made at the same time

²¹⁹ Debt Relief Act (2010) para 5.

as the payments to other creditors. However, the holdout creditors' share will be reduced in accordance with what is considered sustainable within the HIPC framework. The rateable payment formula, as it is interpreted by the District Court, will therefore be modified. The UK legislation will, with respect to HIPC debts, succeed in ensuring that holdout creditors are not advantaged over participating creditors. Despite the increased incentives created by the NML Capital case, the UK Act has ensured that there is no extra incentive to hold out from the HIPC initiative.

There is also another way in which the NY District Court orders may affect the UK Act: holdout creditors may choose not to go to court in the UK to execute the US judgment, but instead will rely on the US injunction on third parties to obtain full payment. If third parties choose to obey the injunction, they will refuse to execute payments (or to help in this task) from the sovereign debtor to the exchange bondholders, as long as the holdout creditors do not receive a rateable payment. One question arising is whether the sovereign debtor's voluntary payment of its holdout creditors, after submitting to pressure from third parties under the injunction, is subject to the UK Act. According to the UK Act, payments in connection with compromise agreements on sovereign debt; restructured debt; payment orders on sovereign debt obtained through litigation; and execution of foreign payment judgments and awards, are all subject to the maximum cap.²²⁰ Payment by the sovereign debtor, under pressure from third parties obeying the US injunction, is nevertheless a voluntary payment based on the original contract. This type of payment is not listed in the UK Act directly, which suggests that a voluntary payment is not subject to the maximum cap. Furthermore, the injunction itself does not relate directly to the amount recoverable, which is at the core of the UK regulation. To a certain extent, the injunction seems able to circumvent the UK Act because it obliges third parties to apply pressure to the sovereign debtor to repay the debt under the original (non-restructured) loan agreement. On the other hand, voluntary payments avoiding the maximum cap is contrary to the aims of the legislation, namely to safeguard the fulfilment of the debt relief under the HIPC initiative. Whether such payment falls within the scope of the UK Act has not been tried in court and the result can be said to be uncertain. It is therefore difficult to determine the consequences of the *pari passu* order and the corresponding injunction for the UK Act.²²¹ If voluntary payment in accordance with the original contract does fall within the scope of the UK Act, the holdout creditors' claim will be modified in accordance with the maximum cap. It will however be difficult to ensure that voluntary payments made

²²⁰ *ibid* section 3.

²²¹ Another question is whether or not third parties subject to the US injunction, but who also have contract obligations under UK law that will be breached if the injunction is respected, may be freed from liability for breach of contract due to the US injunction. *Knighthead Master Fund Lp v. The Bank of New York Mellon* (2015) did not explicitly answer this question, but made comments which implied that it is unlikely that a third party would be freed of its liability in such situations.

by sovereign debtors to holdout creditors are also subject to the maximum cap laid down in the UK Act. If voluntary payment does not fall within the scope of the Act, the result will be that voluntary payments resulting from third party pressure under the US injunction must be accepted.

With respect to the Model CAC introduced in the euro zone countries, the novel interpretation of *pari passu* and the corresponding injunction will not affect its objective in any significant sense. CACs, like *pari passu* clauses, are contractual provisions that bind the contracting parties. The implementation of CACs in sovereign bonds ensures in principle that all courts and tribunals will accept a restructuring accepted by the majority of the creditors.

4.2.5 Preliminary Conclusions

In section 4.2, I have presented two important legal outcomes of *NML Capital, Ltd. v. the Republic of Argentina*, namely the novel interpretation of the *pari passu* clause and the use of a far-reaching injunction to enforce the sovereign debt payment order. I argue that these represent new legal tools in the sphere of sovereign debt disputes, which may affect the way creditors act in relation to a sovereign debt restructuring.

I argue that the *pari passu* interpretation provides stronger rights for holdout creditors and that these rights become effective through the issuance of the related injunction. Because the injunction avoids the ordinary attachment regime and the rules on sovereign immunity, it has managed to provide a more effective tool for holdout creditors to obtain full payment in accordance with the original non-restructured loan agreement. I also show that many outstanding sovereign bonds contain a *pari passu* clause with wording similar to the clause in the NML Capital case. The outcome of the NML case may thus have consequences for a broad range of sovereign bonds. I also argue that the precedent created by the NML Capital case may lead to increased incentives for minority creditors to hold out from restructuring processes in general, which may present a challenge to the system of voluntary debt restructurings.

With respect to the Belgium Act and the euro area Model CAC examined in chapter 3, I conclude that these laws will probably be unaffected by the legal developments. How and to what extent the legal developments will affect the UK Act is less clear. Regardless of how the three legal regimes are affected by these new legal tools, it is worth recalling the conclusions in section 3.4, namely that the Belgian and UK legislation in particular have a limited impact on overall incentives for minority creditors to participate in sovereign debt restructuring. The euro area Model CAC does however constitute a relatively strong tool, which has the potential to ease coordination problem amongst creditors in a restructuring process, and so contribute to a reduction in holdout litigation. The impact of the euro area Model CAC is therefore likely to counter the new legal developments.

The overall conclusion at this point is that 1) the legal outcomes of the NML Capital case constitute strong legal tools for minority holdout creditors, which increase the incentives for creditors to hold out from sovereign debt restructuring processes in general; 2) the new legal tools do not significantly weaken the Belgian legislation or the euro area Model CAC, both of which are aimed at encouraging participation in sovereign debt restructuring and reducing sovereign debt litigation; and 3) the legislation in Belgium and the UK has little impact on the increased incentives to hold out from sovereign debt restructurings created by the new legal tools of the NML Capital case. CACs, on the other hand, stand out as being the most robust means of handling the increased incentives for minority creditors to hold out from sovereign debt restructurings and of limiting sovereign debt litigation.

4.3 Proceedings before the International Centre for Settlement of Investment Disputes (ICSID)

4.3.1 Introduction

The other legal development in the sphere of sovereign debt disputes, which will be described in this section, stems from legal proceedings before the International Centre for Settlement of Investment Disputes (ICSID). ICSID is an autonomous international institution established under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States with over one hundred and forty member States.²²² The primary purpose of ICSID is to provide facilities for conciliation and arbitration of international investment disputes. The legal basis of a claim connected to an international investment dispute under ICSID is a bilateral investment treaty (BIT). A BIT may confer jurisdiction to a variety of investor-dispute settlement arbitration tribunals, but ICSID is one of the more common arbitration forums. BITs aim to attract foreign direct investment in less developed and emerging economies, by guaranteeing foreign investors the right to individual protection and, if necessary, the right to appropriate defence and compensation.²²³ For the ICSID to accept jurisdiction over an investment dispute, a legal dispute has to exist between one of the centre's contracting member states and a national of another contracting member state.²²⁴ Recourse to ICSID conciliation and arbitration is entirely voluntary. However, once the parties have consented to arbitration under the ICSID Convention, neither party can unilaterally withdraw its consent.²²⁵

Parallel to the proceedings in the New York District Court brought by NML Capital, 180,000 Italian holders of defaulted Argentine debt pursued arbitration before ICSID through the so-

²²² ICSID Convention (1965).

²²³ Piétrus & Ooms (2005) 153.

²²⁴ ICSID Convention (1965) Art. 25.

²²⁵ *ibid* chapter II.

called Task Force Argentina.²²⁶ The Task Force claimed compensatory damages due to Respondent's alleged breach of its obligations under the 'Agreement between the Argentine Republic and the Republic of Italy on the Promotion and Protection of Investments' (The Argentina-Italy BIT), signed in Buenos Aires on 22 May 1990.²²⁷ The case is named *Abaclat and Others v. Argentina*, and one of the questions raised was whether the claims fell within the scope of protection afforded by the Argentina-Italy BIT. In 2011 the majority of the ICSID Arbitral Tribunal confirmed its jurisdiction and concluded for the first time that sovereign bonds *may* constitute an investment in the sense of Article 25 of the ICSID Convention and Article 1 of the Argentina-Italy BIT.²²⁸ The award on the merits is still pending, but the decision on jurisdiction is itself quite important because this is the first time the ICSID has accepted jurisdiction over a sovereign debt dispute. Up until now, sovereign debt disputes have been brought before national courts, and occasionally ordinary arbitral tribunals, one of which is normally the designated court in sovereign loan contracts. (In *Abaclat v. Argentina*, ICSID was not the designated court under the loan contract).

4.3.2 Consequences of ICSID accepting jurisdiction over Sovereign Debt Disputes

As explained in the section above, the majority of the ICSID tribunal concluded that sovereign bonds fell under the Argentina-Italy BIT and that ICSID was competent to hear such a claim. The scope of this thesis is too narrow to delve further into the content of the jurisdictional requirements and the related question of what constitutes an investment according to Article 25 of the ICSID Convention. In the context of this thesis, the important point is to note the possibility that ICSID may in the future confirm jurisdiction over sovereign debt disputes. Several features related to ICSID as an alternative litigation path may affect the incentives for different classes of creditors to hold out from debt restructurings. In the following I will examine three of these features.

First, the traditional enforcement mechanism set out in Article 54 of the ICSID Convention is deemed to be quite strong. Article 54(1) of the ICSID Convention provides that each contracting state must enforce the pecuniary obligations imposed by ICSID arbitration awards 'within its territories as if it were a final judgment of a court in that state'. State immunity from execution of property is still relevant when enforcing ICSID awards and provides some protec-

²²⁶ Choi, Declaration (2012) 3. See *Abaclat and Others v. Argentine Republic* (2011). After the second restructuring round in 2010, the number dropped to approximately 60 000.

²²⁷ *Abaclat and Others v. Argentine Republic* (2011) 10.

²²⁸ One of the disagreements between the arbitrators was whether the definition of investment given in the BIT is decisive for whether the ICSID tribunal can accept jurisdiction, or whether the action that has caused the dispute also has to fall under the definition of investment laid down in the ICSID convention. The dissenting judge argued that a BIT cannot expand the scope of the ICSID convention. See the Dissenting judge's opinion in *Abaclat and Others v. Argentine Republic* (2011).

tion under the ICSID Convention: Article 55 provides that ‘[n]othing in Article 54 shall be construed as derogating from the law in force in any Contracting State relating to immunity of that State or of any foreign State from execution’. However, in practice it has been shown that the rate of compliance with ICSID awards is very high, compared to national court orders regarding sovereign debt disputes.²²⁹ If the likelihood of successful enforcement of holdout claims in sovereign debt disputes increases, other creditors are likely to be discouraged from participating in a restructuring offer because ‘[c]reditors will not be willing to take a loss knowing that holdouts may receive full payments elsewhere’.²³⁰

Second, the bilateral approach taken in BITs introduces preferential treatment features: if sovereign bonds are to be considered an investment in the sense of a BIT and the ICSID Convention, all creditors must be offered a restructuring on equally advantageous (or disadvantageous) terms. More precisely, the terms must be qualitatively the same, relative to the creditor’s share of the bonds and the type of bond (maturity, interest rate... etc.). When thousands of investors holding sovereign bonds are subject to restructuring, and the terms of the sovereign bonds vary, it will be harder to get the different bondholders to agree on what actually constitutes a restructuring offer on equal terms. If strict preferential treatment features get introduced into the restructuring process as a condition for valid restructuring, the necessary coordination among bondholders is likely to be more difficult.²³¹

Third, and this is perhaps the most remarkable consequence of ICSID accepting jurisdiction in sovereign debt disputes, the objective of CACs may be undermined.²³² The reason for this is that in the sphere of investment treaty arbitration there is a distinction between contract claims and treaty claims. This has been accepted by a number of tribunals, including in *Viviendi v. Argentina II*:

Articles 3 (fair and equitable treatment) and 5 (expropriation) of the BIT do not relate to breach of a municipal contract. Rather, they set an independent standard. A state may breach a treaty without breaching a contract; it may also breach a treaty at the same time it breaches a contract.²³³

²²⁹ Ishikawa (2014) 77, citing the finding of Reed et al (2011) 186 and Fouret (2012) 327.

²³⁰ Ishikawa (2014) 77.

²³¹ Piétrus & Ooms (2005) 163.

²³² The bond contract at stake in *Abaclat and Others v. Argentine Republic* (2011) did not contain CACs. The statement that CACs may be disregarded is based on the reasoning of the ICSID tribunal, and the fact that it distinguishes between contract claims and treaty claims.

²³³ *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentina* (2007) para. 7.3.10.

This means that a treaty claim may arise from a contractual relationship between foreign investors and the state where the investment takes place independently of the existence of a breach of contract.²³⁴ In other words, regardless of the contractual position of a debtor state under a relevant bond, it may still be found responsible for a breach of treaty obligations.²³⁵ At the same time, a treaty claim cannot arise if the investor claim is based only on an alleged breach of contract by the state where the investment takes place (the host state).²³⁶ In *Abaclat* the tribunal classified the enactment and implementation of laws, such as ‘the Lock Law’, as acts independent of Argentina’s conduct as a party to the bond contracts. The tribunal further established that such acts constituted potential breaches of treaty obligations and not just a potential breach of a commercial contract. The result of this distinction between contract claims and treaty claims is that the ICSID tribunal may find that a sovereign debt restructuring, or accompanying conditions, constitute a breach of the ICSID treaty despite the fact that the debt restructuring is in accordance with the CACs described in the debt contract between the parties. This implies that bondholders may be able to obtain compensation even though the ‘contractually prescribed majority of bondholders accepted the sovereign debt restructuring’.²³⁷ In other words, the CAC laid down in a bond contract may actually become ineffective in binding holdout creditors. As mentioned in section 3.3, the IMF, ICMA and the EU, through the euro Model CAC, do rely on CACs to reduce collective action problems and holdout litigation. Recourse to ICSID arbitration could thus ‘create a legal gap in the international community’s collective action policy’.²³⁸

4.3.3 The effect on the examined legislation

I argue that these three features - the enforcement mechanism, preferential treatment features, and the differentiation between treaty claims and contract claims leading to a situation where CACs may be disregarded - all contribute to increase the overall incentives for minority creditors to holdout from sovereign debt restructurings. In addition, the fact that ICSID has accepted jurisdiction over sovereign debt disputes may also affect the laws introduced in Belgium, the UK and in the euro area countries.

²³⁴ Ishikawa (2014) 73.

²³⁵ *ibid* 74.

²³⁶ There is however an exception to this starting point in investment arbitration. The so-called ‘umbrella clause’ requires that the state where the investment takes place respect any obligation assumed by it with regard to a specific investment. This means that a broadly drafted umbrella clause can turn a breach of contracts into a treaty breach, including in commercial contracts. This was not the case in *Abaclat and Others v. Argentine Republic* (2011) however. See more at *ibid* 73.

²³⁷ Waibel (2007) 736.

²³⁸ *ibid* 736. A fourth argument against ICSID jurisdiction over sovereign debt disputes, which is often mentioned in the debate is that it conflicts with work on a more comprehensive and transparent debt work-out mechanism

The Belgian legislation immunises certain funds and property through national legislation, to protect them from attachment in fulfilment of sovereign debt claims, for example. As discussed in section 4.3.2, there is evidence that it is easier to enforce ICSID awards than national or municipal court orders. This may suggest that ICSID's acceptance of jurisdiction over sovereign debt disputes could weaken the protection set out in the Belgian Act. However, as previously mentioned, the ICSID Convention does specify that nothing in Article 54, which regulates enforcement, shall be construed as 'derogating from the law in force in any Contracting State relating to immunity of that State or of any foreign State from execution'. For these reasons, the fact that ICSID has accepted jurisdiction over sovereign debt disputes is not likely to affect the Belgian legislation.

As described in section 3.2, the UK Debt Relief (Developing Countries) Act from 2010 puts a cap on certain recoverable funds in sovereign debt litigation in national courts.²³⁹ This cap also applies to enforcement of claims based on a foreign court order or arbitral award, including ICSID awards. Thus the objective of the UK legislation is in principle intact.²⁴⁰ (A UK law putting a maximum cap on a claim regarding British debts would have been more problematic, because such a claim could be protected under the British BITs. A sovereign debt claim from a national of a third country against a foreign state does not however fall under the protection of a British BIT).

I ended the previous section by describing how ICSID may undermine the objective of CACs. Such a situation will of course also affect the euro area Model CAC. If holdout creditors can seize an alternative court that disregards the contractual effects of CACs, the euro zone legislation will be in danger of being a much weaker incentive to restructure than wished for.

4.3.4 Preliminary conclusions

In a recent case, *Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic*, decided on 9 April 2015, the ICSID tribunal seems to depart from previous reasoning with respect to its categorisation of sovereign bonds as an investment under the ICSID convention.²⁴¹ The case concerns a dispute over an agreement between the government of Greece and Slovakia and Cyprus respectively, and the ICSID convention. The underlying dispute is related to Greek sovereign bonds and the debt restructuring carried out in 2012, but in this case the Tribunal only considered the question of jurisdiction. The award begins by considering whether the

²³⁹ Debt Relief Bill (2010) 9.

²⁴⁰ As previously mentioned, I assume that there is no conflict between international obligations on the execution of foreign judgments and the UK legislation. An examination of possible conflicts would be difficult within the time frame of this thesis.

²⁴¹ *Poštova banka, a.s. and ISTROKAPITAL ES v. Hellenic Republic* (2015).

Greek sovereign bond falls under the respective BITs. Due to unclear wording and inconsistent references to which obligations and securities constitute an investment under different Greek BITs, the ICSID Tribunal concluded that the sovereign bonds did not constitute an investment under the specific BITs. For these reasons, the ICSID Tribunal declined jurisdiction. However, in an *obiter dictum* the Tribunal chose to investigate whether the sovereign bonds in question could constitute an investment under the ICSID Convention.²⁴² It is in this *obiter dictum* that the tribunal seems to disagree with the majority arbitrators of the *Abaclat* case and concludes that a sovereign bond does not constitute an investment under the ICSID convention. The majority of the tribunal highlights the fact that for something to be categorised as an investment in an economic sense, there has to be an element of *contribution* to the creation of value, as opposed to a process of exchange of values (for example, a sale). Furthermore, there has to be an element of *duration* and an element of *risk*. This risk is not the commercial risk or a sovereign (political) risk, but an operational risk. Such a risk is described as ‘inherent in the investment operation in its surrounding – meaning that the profits are not ascertained but depend on the success or failure of the economic venture concerned...’.²⁴³ The Tribunal accepted that there was an intended duration of possession of the Greek sovereign bonds. However, the Tribunal concluded that ‘the element of contribution to an economic venture and the existence of the specific operational risk that characterizes an investment under the objective approach are not present here’.²⁴⁴ The two judgments *Abaclat* and *Poštová banka* seem to contradict each other, and leave the question of whether ICSID will in the future accept jurisdiction in sovereign debt disputes (related to sovereign bonds) open and unsettled. Although there are case-specific circumstances that differentiate *Abaclat* from *Poštová banka*, the diverging outcomes in the two cases seem to be based on a difference of opinion amongst the arbitrators with respect to which requirements must be fulfilled for the ICSID to confirm jurisdiction. To my knowledge there is yet another sovereign debt dispute pending in which ICSID will have to consider whether to accept jurisdiction or not; this third case, may provide more certainty.

It is not yet settled whether the ICSID will accept sovereign debt disputes in the future. However, if it does accept jurisdiction, there is a risk that it may disrupt the current system of sovereign debt restructurings, which is based on a voluntary contractual approach. This disruption is mainly caused by the fact the ICSID may disregard CACs when deciding on whether there is a breach of the treaty or not, which may also invalidate restructuring agreements made

²⁴² The examination was made under the assumption that the ICSID tribunal should apply an ‘objective test’ when considering whether something constitutes an investment under the ICSID convention. For further discussion of the subjective vs. the objective test, see Waibel (2007).

²⁴³ *ibid* section 369.

²⁴⁴ *ibid* section 371.

on the basis of CACs. Based on the examination in this chapter, I conclude that legislation in both the UK and Belgium is likely to be unaffected by the legal changes that will follow if ICSID accepts jurisdiction over sovereign debt disputes. However, as these statutes have little effect on the overall incentives for sovereigns to restructure, they will not be able to correct the reinforced incentives for creditors to hold out that may arise if ICSID accepts jurisdiction in the above mentioned cases.

5 Concluding Remarks

5.1 Final Conclusion

In my thesis I consider the problem of creditor holdouts in sovereign debt restructurings and minority creditors who free ride on restructuring processes paid for by the majority creditors and the sovereign debtor. I examine whether legislation from Belgium, the UK and a euro area treaty has been successful in limiting the number of minority creditors who hold out from restructuring processes and litigate to obtain full payment under the original non-restructured loan agreement.

In chapter 3, I discussed the effectiveness of the three legislative initiatives. This analysis was based on the legal framework of sovereign debt as it was prior to 2010. I found that the Belgian Act, the UK Act and the euro area Model Collective Action Clause (CAC) cover different situations in which a holdout creditor may impede sovereign debt restructuring and hamper the positive impact of such restructuring. I concluded that the legislation in Belgium and the UK is quite narrow and only has a limited effect on overall incentives for creditors to participate in sovereign debt restructurings and refrain from sovereign debt litigation to obtain full payment under a non-restructured bond. The euro area Model CAC, on the other hand, is more comprehensive and powerful, because it aims to limit holdout opportunities for minority creditors by making it possible for the majority of the creditors to bind the minority to participate in a restructuring. The overall conclusion, based on a theoretical analysis of the three legislative approaches, is that all of them correct some of the negative consequences of creditors holding out from restructuring processes. There are still several loopholes, however, leaving various opportunities for creditors to successfully hold out from restructuring processes and subsequently litigate.

My general and theoretical analysis indicates that there is a need for stronger regulation to obtain sufficient incentives to ensure successful sovereign debt restructurings and to dissuade minority creditors from free-riding on necessary restructuring processes. In section 3.4.2, I looked at empirical data on sovereign debt restructurings, sovereign debt litigation and holdout behaviour from 1980 to 2010, allowing me to test the conclusions of the general analysis. The data indicates that the problem of holdout creditors is relatively limited, which may suggest that introducing new regulation to ensure that all creditors take part in debt restructurings is unnecessary. I argue that one of the reasons why relatively few creditors litigate against a defaulting sovereign is that the rules on sovereign immunity from attachment make it difficult in practice for creditors to execute a sovereign debt judgment. The most important findings showed that the number of sovereign defaults and restructurings has gone down in the last ten years, but that there has been an increase in default-related creditor litigation. At the same time, the overall number of sovereign debt restructurings and the average time required to conclude such restructurings is relatively low. This indicates that the contractual, market-

based approach with voluntary restructurings has worked reasonably well in securing creditor participation and avoiding protracted negotiations.²⁴⁵

While chapter 3 deals with the situation prior to 2010, chapter 4 turns to legal developments since 2010. In the latter chapter, I examined certain legal proceedings and discussed whether these may have an impact on 1) the future participation of creditors in sovereign debt restructurings and 2) the effectiveness of the examined legislation in handling the problems raised by these more recent developments. The focus of this chapter was on the outcome of litigation before the New York District Court and the International Centre for Investment Disputes (ICSID) in *NML Capital, Ltd. V. the Republic of Argentina* and *Abaclat and Others v. Argentina* respectively. I argue that the novel interpretation of the *pari passu* clause adopted by the New York District Court, and the injunction issued in relation to it, represent new and strong legal tools for minority creditors who seek to hold out from restructurings to obtain full repayment under a non-restructured loan agreement. According to the District Court's interpretation, the *pari passu* clause gives holdout creditors a right to be paid in accordance with the non-restructured loan agreement, if the debtor chooses to pay the creditors who have accepted a restructuring. When such a right is combined with an injunction that also binds third parties, such as the injunction issued by the District Court, the chances of holdout creditors succeeding in their claims for full repayment will significantly improve. One of the findings in chapter 3 was that sovereign immunity from attachment remains an important practical obstacle for creditors seeking to execute a sovereign judgment. I argue that the main reason why the *pari passu* interpretation, combined with a strong injunction binding third parties, is such a forceful tool is the fact that the injunction circumvents these rules on sovereign immunity.

In examining Belgian and UK legislation in chapter 4, I found that they have a limited effect on the increased incentives to hold out from sovereign debt restructurings introduced by the NML Capital case. Because CACs, like the *pari passu* clause, are contractual provisions, they are able to bind minority creditors in sovereign debt restructurings and deter sovereign debt litigation. Increased implementation of CACs, and strengthening of CACs themselves, may correct the increased incentives for creditors to hold out from sovereign debt restructurings that are introduced by the District Court's ruling in the NML Capital case. A 2013 IMF report on sovereign debt restructuring supports my conclusion that there has been an increase in incentives for creditors to hold out by stating that '[t]he ongoing Argentina litigation has exacerbated the collective action problem, by increasing leverage of holdout creditors'.²⁴⁶ In the same report, the IMF also admits that 'while creditor participation has been adequate in recent

²⁴⁵ See IMF (2013) 26-27.

²⁴⁶ *ibid* 26-27

restructurings, the current contractual, market-based approach to debt restructuring is becoming less potent in overcoming collective action problems, especially in pre-default cases'.²⁴⁷ One of the solutions put forward by the IMF to overcome the problems that have arisen as a consequence of these legal developments is to strengthen CACs with a single limb voting procedure. It is more difficult for creditors to obtain a blocking position when there are no requirements for a majority in favour of restructuring within each series, but only on an aggregated basis. For this reason, and as discussed in section 3.3.3.1, an aggregated single-limb voting procedure is likely to improve the chances of successful debt restructuring.

The IMF report does not discuss the legal consequences of the rulings in certain sovereign debt disputes before the International Centre for Settlement of Investment Disputes (ICSID). After the Argentine default, sovereign debt disputes were brought before ICSID and for the first time ICSID accepted jurisdiction over such disputes. Whether or not ICSID will accept disputes over sovereign debt (sovereign bonds) in the future remains unsettled, but if it does I argue that it may disrupt the current system of sovereign debt restructuring, which relies on a voluntary contractual approach. The reason for this is that when ICSID handles a dispute, it considers whether or not there has been a breach of an investment treaty. In doing this it may disregard contractual terms, such as CACs, and it may therefore also end up invalidating a restructuring agreement made on the basis of CACs. Of the three legislative initiatives examined in this thesis, I concluded that the euro area Model CAC is the most potent legislation with respect to limiting the problem of creditors holding out from restructuring processes and litigating for full payment. As previously explained, the IMF, ICMA and the EU through the euro area Model CAC, rely primarily on CACs to reduce the collective action problems during debt restructurings and holdout litigation. Recourse to ICSID arbitration in sovereign debt disputes may thus create a legal gap in the international community's efforts to limit the problem of minority creditors holding out from restructuring processes.²⁴⁸ In addition to weakening the existing tools that contribute to limiting hold out problems, a situation in which ICSID accepts jurisdiction over sovereign debt disputes may also further strengthen the incentive for creditors to hold out from restructuring processes because 1) the equal treatment features, which are important parts of investment treaties, may make it more difficult for creditors to agree on a restructuring offer, and 2) because ICSID awards are deemed easier to execute compared to national and municipal judgments and other arbitral awards. With this in mind, I argue that the legal developments in the aftermath of the Argentine default in 2001 and the subsequent litigation, have led to a situation where the incentives to take part in restructuring processes have been weakened.

²⁴⁷ *ibid* 2.

²⁴⁸ Waibel (2007) 736.

With respect to the legislation examined in chapter 3, I conclude that the legislation in Belgium and the UK will probably not be affected if ICSID starts to accept jurisdiction over sovereign debt disputes. Given that an ICSID tribunal can disregard a CAC, however, it is clear that the euro area Model CAC may become less effective.

To sum up, in my thesis I conclude that legislation in both Belgium and the UK is quite narrow and does not manage (or even attempt) to affect the overall incentives for minority creditors to participate in sovereign debt restructurings and not litigate for full payment under the original non-restructured loan agreement. The euro area Model CAC, though it could be strengthened in various ways, is a more comprehensive tool and may significantly improve the likelihood of obtaining a successful restructuring. However, the legal developments that have taken place in the sphere of sovereign debt disputes since 2010 have disrupted the voluntary system of sovereign debt restructurings. I argue that the legal developments (the *pari passu* interpretation, the injunction and the possibility of ICSID accepting jurisdiction over sovereign debt disputes) have strengthened the creditor's right to hold out from sovereign debt restructurings and claim full payment. Even CACs, believed to be the most potent tool to deal with holdout behaviour and free-riding during sovereign debt restructurings, are in danger of losing their effectiveness.

Compared to international trade, international finance is subject to very little international regulation. The analysis in this thesis shows that the sphere of sovereign debt is quite complex and fragmented, and that it is difficult to establish national rules that are capable of responding to international challenges. The main observation that can be drawn from my thesis is that there seems to be a need for stronger international cooperation to deal with the problem of holdout creditors in sovereign debt restructurings.

5.2 Recommendations and Further Research

Sovereign debtors, creditors and academics are all concerned about the future of sovereign lending and restructurings. Concern has grown especially in the aftermath of the NML Capital case because the consequences now also impact the majority creditors who took part in the restructurings. Several actors are now engaged in finding new solutions to the challenges posed by minority creditors holding out and which are in danger of disrupting the voluntary system of sovereign debt restructuring.

Based on the findings in my thesis I will propose some initiatives which could contribute to limiting holdout behaviour and enhance the likelihood of achieving successful sovereign debt restructuring:

- Increased implementation of CACs in sovereign bonds. The implementation of CACs in developed economies' sovereign bonds is also important, because it can contribute to making CACs a market standard.
- CACs should be strengthened so that they use a single-limb voting procedure, in accordance with the recommendations of the IMF and ICMA.
- Sovereign bonds should specify the content of the pari passu clause, so that it cannot be interpreted in the same way it was interpreted by the New York District Court. The ICMA has suggested such a standard pari passu clause.²⁴⁹
- To ensure that sovereign bonds and sovereign debt disputes are not subject to the jurisdiction of ICSID in the future, governments can implement a 'carve out clause' in their Bilateral Investment Treaties (BITs). This clause should state that sovereign bonds are not to be considered as investments under the BIT or the ICSID convention.²⁵⁰
- Thought should be given to the idea of establishing an international sovereign debt restructuring mechanism, for example through the General Assembly's Ad hoc Committee on sovereign debt restructuring processes.²⁵¹

To overcome future challenges regarding the resolution of sovereign debt crises in general, and holdout problems during debt restructurings more particularly, further research should be undertaken on the question of ICSID and its jurisdiction over sovereign debt disputes. Such research is especially important because sovereign debt cases concerning ICSID's jurisdiction are still pending and a future award may lead to clarification of the legal situation. The process of the General Assembly's Ad hoc Committee on sovereign debt restructuring, and the different suggestions for establishing a sovereign debt restructuring mechanism should also be further examined. The same applies to the practice of aggressive holdout creditors, so called vulture funds, in order to create effective measures limiting the negative consequences of their behaviour.

²⁴⁹ The new standard clause is meant to facilitate future sovereign debt restructurings and specifies that 'the Issuer shall have no obligation to effect equal or rateable payment(s) at any time with respect to any such other External Indebtedness and, in particular, shall have no obligation to pay other External Indebtedness at the same time or as a condition of paying sums due on the Notes and vice versa'. See *Pari Passu Clause, Standard* (2014).

²⁵⁰ This latter measure is relevant for Norway where a new model agreement for BITs currently is being drafted

²⁵¹ The Ad hoc Committee was established pursuant to General Assembly resolution 69/247 (2014)- The Committee was initiated by the G77 and is more or less boycotted by the USA, the EU, Japan and Canada.

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Figures

Figure 1: Total number of bond issues by governing law

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Figure 2: Stock of External Debt by Borrower Type and Maturity, 2000-2011

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Figure 3: Differences between holdout legislation

Figure 4: Creditor Litigation after Defaults/Restructurings: New Cases Filed per Year

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Figure 5: Different versions of *pari passu* over time

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